2017 ANNUAL REPORT

NEW HEIGHTS.
NEW AMBITIONS.

ALERUS
FINANCIAL CORPORATION

THE POTENTIAL FOR GREATNESS EXISTS IN EVERY BUSINESS AND IN EVERY PERSON.

ALERUS SERVES AS A CATALYST FOR OUR CLIENTS TO TURN THAT POTENTIAL INTO ACHIEVEMENT, TO MAKE THE ASPIRATIONAL REAL, AND TO CHART A COURSE TOWARD FINANCIAL HEALTH. INVESTING IN THEIR JOURNEYS ALLOWS US TO CREATE VALUE FOR YOU, OUR STOCKHOLDERS.

Our story is a collection of client stories, spanning across more than a century. Yet for all of that history, our greatest honor lies ahead: the opportunity to accompany still more clients as they navigate their financial lives to achieve their dreams.

COMPANY PORTFOLIO

Diversified financial services company

$2.1 billion banking assets

$3.8 billion assets under management

$28.2 billion assets under administration

$867.3 million mortgage loans originated

STOCKHOLDER RETURN

Earnings per common share: $1.10

Dividends per share: $0.48

Stock price range 2017: $16.67 - $20.75

Last Trade 2017: $20.45

Last Trade 2016: $17.00

Total stockholder return: 23.1%*

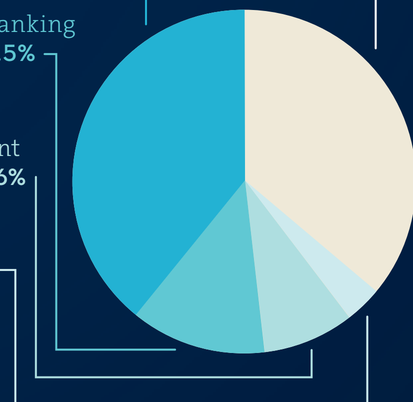
**Calculated as Last Trade 2017 minus Last Trade 2016 plus dividends per share divided by Last Trade 2016.*

DIVERSIFIED REVENUE STREAM

NET REVENUE

$171.1 million

- **$67.7 MILLION** NET INTEREST INCOME
- **$103.5 MILLION** NON-INTEREST INCOME



CORE STRENGTHS

Strong balance sheet

Diversified earnings

Relationship-oriented business model focused on advice

Highly skilled professional service employee base

Commitment to business expansion opportunities

Commitment to leadership development

Commitment to technology and innovation

Loyal client base

CLIENT BASE

45,800 consumers

11,425 businesses

6,500 employer-sponsored retirement plans

354,000 employer-sponsored retirement plan participants

40,000 health savings account participants

14,000 flexible spending account/health reimbursement arrangement participants

CORE BUSINESS LINES

Business Banking

- Commercial and commercial real estate lending
- Agriculture lending
- Treasury management
- Deposit services

Consumer Banking

- Deposit products and services
- Consumer lending
- Private banking

Mortgage

- Residential mortgage lending
- Purchasing or refinancing
- Residential construction lending
- Home equity/second mortgages

Retirement and Benefits

- Retirement plan administration
- Retirement plan investment advisory
- ESOP fiduciary services
- Payroll administration services
- HSA/FSA/HRA administration
- COBRA

Wealth Management

- Advisory services
- Trust and fiduciary services
- Investment management
- Insurance and health planning
- Financial planning
- Education planning

ALERUS TEAM

789 employees

MARKET PRESENCE

Grand Forks, ND

- Five full-service banking and wealth management offices

Fargo, ND

- Three full-service banking and wealth management offices

Twin Cities, MN

- Six full-service banking and wealth management offices
- Two residential mortgage offices

Duluth, MN

- Two full-service banking and wealth management offices

Scottsdale, AZ

- One full-service banking and wealth management office

NATIONAL PRESENCE

- Three retirement and benefits offices in Minnesota
- Two retirement and benefits offices in Michigan
- One retirement and benefits office in New Hampshire
- Serve clients in all 50 states through retirement and benefit services

NATIONALLY RECOGNIZED FOR OUR PERFORMANCE

Earned BauerFinancial's highest 5-star rating, a distinction for banks excelling in areas of capital adequacy, profitability, and asset quality. *(Jan. 2018)*

Ranked 56th on the 2017 Bank Performance Scorecard within the $1-5 billion category by *Bank Director* magazine, a rating recognizing performance based on profitability, capitalization, and asset quality. *(July 2017)*

Ranked 21st for number of sponsors, 27th for number of participants, and 26th for size of plan assets under management by Pension & Investments, who ranks the top recordkeepers nationally by size. *(Sep. 2016)*

DEAR STOCKHOLDERS, CUSTOMERS, AND FRIENDS,

I BEGIN THIS LETTER WITH A SENSE OF GRATITUDE AND PRIDE ABOUT ALERUS AND WHAT WE ACCOMPLISHED TOGETHER IN 2017. OURS IS A VIBRANT COMPANY WITH AN EXTRAORDINARY HERITAGE, AN EXCITING PRESENT, AND A PROMISING FUTURE.

2017 was a transformative year for Alerus in many ways. Not only did we perform very well, but we did so while taking steps to reshape our company from the inside out, putting ourselves in position to strengthen relationships with clients, work even better together, and continue to create value for our stockholders.

Our industry is rapidly evolving, driven largely by technological advancements and a corresponding shift in the ways clients interact with their chosen financial institutions. This presents an opportunity for our company, which has been built thoughtfully, strategically, and always with a focus on what is best for clients, to meet their needs in unique, innovative ways. This shift also creates opportunities to expand our reach, make an impact on more clients, and grow our franchise. That is what our transformation is all about.

BECOMING ONE ALERUS

We began the year by committing to an initiative called One Alerus. This is not so much a new business model as it is an expression of who we are and where we want to go. Underpinning One Alerus is a passion for serving clients through a combination of powerful technology and skilled advisors — a "high-tech, high-touch" approach that we believe clients of today, and certainly those of tomorrow, both demand and deserve.

To help make One Alerus successful, we redesigned the structure of our company, adding new leaders, reorganizing teams, and ensuring that our employees are in position to maximize their talents. This will help us deliver on the high-touch aspect of our approach as we move forward. The high-tech portion is also underway, as we engaged with a leading financial technology company to create an easy-to-use account platform for our clients and began a relationship with a world-class provider of client relationship management tools to manage interactions with clients.

We view One Alerus as the engine that will power our future growth, heighten our ability to help clients achieve financial security, and ultimately, solidify our standing as the most trusted choice for all our stakeholders. Rooted in ethics and integrity, One Alerus brings together the diverse areas of our company in powerful ways, allowing us to impact clients more meaningfully and generate long-term value for stockholders.

OUR PERFORMANCE AND THE IMPACT OF TAX REFORM

Turning to our financial performance, I am happy to report that 2017 was a strong year, though our results were affected by significant legislative changes. Specifically, at the end of 2017, the United States Congress passed the nation's first major tax reform bill since the Tax Reform Act of 1986. Signed into law by President Donald Trump on December 22, 2017, the Tax Cuts and Jobs Act is expected to positively impact earnings for all companies, including financial institutions, in the future.

However, the new law, which reduced the corporate tax rate from 35 percent to 21 percent, required many companies to remeasure their deferred tax assets in the fourth quarter of 2017. Absent this requirement, Alerus would have reported net income of $20.0 million for the year on pretax earnings of $32.9 million — record pretax earnings for our company.

But the effect of remeasurement was the recognition of a one-time charge of $4.6 million, bringing our reported net income to $15.4 million for 2017.

Despite the tax impact, our performance improved compared to the previous year. Our $15.4 million in net income was an increase of 10.1 percent from 2016 when we earned $14.0 million. 2017 earnings per common share were $1.10 compared to $1.00 in 2016, an increase of 10 percent. Total revenue increased from $167.1 million in 2016 to $171.1 million in 2017 as we benefited from both our expanded product set (HSA, FSA, COBRA, and payroll services gained through our acquisition of Alliance Benefit Group North Central States, Inc.) and our strategies to drive organic growth across business lines. Additionally, we returned to stockholders a cash dividend of $0.48 per share in 2017, an increase of 9.1 percent from 2016's $0.44 per share. We are proud to say our cash dividends have increased approximately 9 percent per year for 37 years. Finally, we delivered a strong total stockholder return of 23.1 percent for the year.

While tax reform reduced this year's reported net income, many of the new provisions, such as a lower corporate tax rate, should provide increased flexibility to invest, grow, and deliver even more value to stockholders in future years. This, along with our enduring commitment to responsible management and our aspirations for measured, steady growth, has Alerus well-positioned to continue delivering value to stockholders. I encourage you to read the accompanying Management's Discussion and Analysis for a full discussion of all the factors underlying this year's performance, including more on the impact of tax reform.

FOCUSING ON CLIENT EXPERIENCE

Today's financial institutions need to be where clients are, by making services available where, when, and how they choose — whether face to face; through mobile devices, personal computers, or ATMs; or over the phone. Being there for clients requires investing in the people and technology that keep us ahead of the curve in digital experience, information accessibility, and the delivery of financial advice.

Through proactive, strategic planning, we have become a valuable resource for clients throughout their financial lifetimes; from first job to first house, from starting a business to succession planning, we are there to help them reach the personal and business milestones that matter most. To ensure that we remain this kind of resource, we are focusing ever more sharply on client experience.

We laid the groundwork this year for a number of improvements designed to make it even easier for clients to interact with us. Geared toward helping people improve their financial fitness, these resources, often based on technology, will provide clients with a better understanding of their current financial picture and guidance on how to achieve their goals, whatever they may be. We are excited to introduce these tools throughout 2018.

A BRIEF RECOGNITION

I must take a moment to acknowledge the contributions of James J. Karley who, after two decades of service as a member of our board of directors, will retire in May 2018. Jim built his businesses — Johnstown Bean, North Central Commodities, and Cavalier Bean — on the same North Dakota ground that gave Alerus its start. It is safe to say we would not be where we are today as a company without his steady guidance and strong, informed voice in the boardroom. On behalf of everyone at Alerus, I thank you, Jim, for 20 years of stewardship and insight.

LEADERSHIP PLANNING AND DEVELOPMENT

Recognizing that our current and future prosperity hinges in large part on the strength and vision of leaders, we continue to build talent internally and find it externally. We are fortunate to have a deep pool of talented leaders within our company, and we are equally fortunate that we are able to attract great people from outside our walls. 2017 was an excellent illustration of this, as we were pleased to welcome two new leaders to our executive team, one from within and another new to Alerus.

Ann McConn, a longtime Alerus employee, became our chief business officer after many years serving in other leadership roles, including market president, director of wealth management, and vice president of retirement and benefits. Ann is an ideal fit on our executive team thanks to her proven strategic approach, client focus, and industry and institutional knowledge. Katie Lorenson, our new chief financial officer, joined us in December after a successful tenure at a publicly traded financial institution where she also held the CFO role. Katie's experience in finance, capital planning, market analysis, and mergers and acquisitions makes her a valuable addition to our company.

Leadership development is a crucial part of remaining an employer of choice and a place where talented people can realize their full potential. We made exciting progress in this regard with the formation of the Alerus Leadership Council, which brings together current and future leaders as a dynamic body that helps move us in the right direction. Through the Council and other methods, we are maintaining a continual focus on developing the next generation of company leadership.

THANK YOU.

I AM ENERGIZED ABOUT THE FUTURE OF ALERUS AND WHAT WE CAN ACHIEVE. IT IS IMPORTANT TO RECOGNIZE AND EXPRESS MY GRATITUDE TO THE PEOPLE WHO MAKE US WHAT WE ARE.

To our stockholders, thank you for placing your confidence in Alerus; we will continue to do all we can to reward it. To our clients, thank you for trusting us as your financial services provider; we will keep working diligently to help you achieve your goals. To our board of directors and our management team, thank you for your support, guidance, energy, and enthusiasm; we all benefit from your perspectives. And finally, to every employee, thank you for your commitment to excellence; you are the faces of this company and I couldn't ask for better representatives.

Randy L. Newman
Chairman, President, and CEO

ALERUS CONTINUOUSLY BALANCES GROWTH, RISK, AND PERFORMANCE TO DELIVER VALUE TO STOCKHOLDERS.

THIS BALANCED APPROACH, ALONG WITH PRUDENT MANAGEMENT, HAS ALLOWED US TO REWARD SHAREHOLDERS WITH 47 STRAIGHT YEARS* OF CASH DIVIDENDS.

2017 marked 20 years since the city of Grand Forks, North Dakota — including our company headquarters — was ravaged by flood and fire. The events of April 1997 are forever etched into the memory of the community and the history of Alerus. The flood and fire, which destroyed our facility and nearly all of our records, could have been the end of our company. Instead it became an inflection point, a springboard into a period of reinvention, expansion, and growth that is still in motion today. Since 1997, company revenue has increased from $31.2 million to $171.1 million, and our market capitalization has increased to more than $280 million. During that time, our common equity has increased from $45.7 million to $180.6 million, our average return on assets (ROA) is 1.16 percent, and our average return on equity (ROE) is 10.79 percent. Our stock price was $3.67 on April 17, 1997, the day the river crested in Grand Forks. At the end of 2017, our stock traded at over $20 a share. We are proud of our performance and the value we have delivered to stockholders since that pivotal point in our history.

As our company's profile increases and as we contemplate future growth, we continue pursuing ways for stockholders to realize the full value of their investment in Alerus. To further increase our visibility with current and future investors, we launched a new investor relations website in April 2017, designed to provide easier access to information about our company. The site, available at **investors.alerus.com**, provides a host of information including detailed financial data, stock price data, investment calculators, and more. The site serves as a useful tool for anyone interested in learning more about Alerus and what we have to offer investors.

2017 was a strong year for Alerus, with pretax earnings reaching a record high of $32.9 million. However, the tax reform package enacted at the end of 2017 required the remeasurement of tax deferred assets, which led to a reduction in net income. Without the remeasurement, our net income would have been $20.0 million for the year, or $1.43 per share. After the required adjustments, Alerus recognized a one-time charge of $4.6 million, reducing net income to $15.4 million, or $1.10 per share. Though tax reform negatively impacted earnings in 2017, we believe, as do many industry watchers, that the new, lower corporate tax rate and other features of the new tax law will strengthen future earnings.

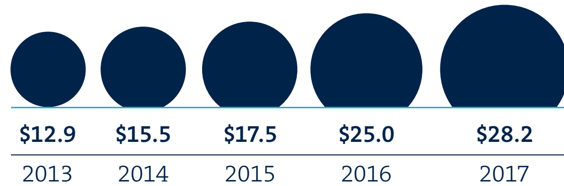
IN SUMMARY, 2017 WAS A YEAR OF REAL PROGRESS FOR ALERUS AND FOR OUR STOCKHOLDERS.

We continue to engage with the institutional investor community, tell the story of our company, and generate interest in the stock. As a company we make calculated choices about how best to conduct business, and stockholder value will always be a pivotal factor in those calculations.

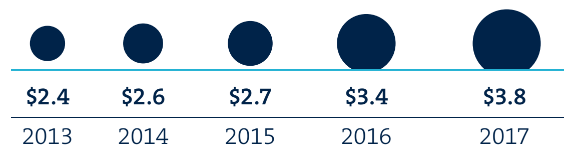
*Data only available since 1969.

ASSET GROWTH (IN BILLIONS)

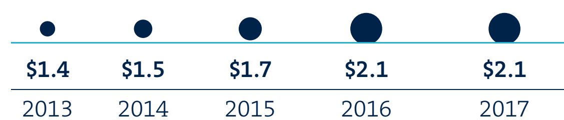
Retirement Assets



Wealth Management Assets

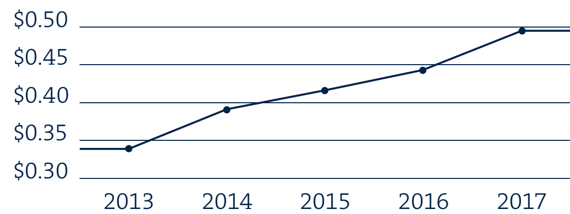


Banking Assets

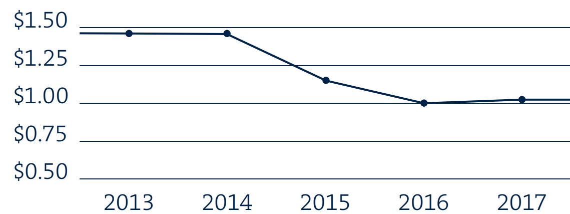


DIVIDENDS AND EARNINGS PER SHARE

Dividends Per Share (DPS)



Earnings Per Common Share (EPS)

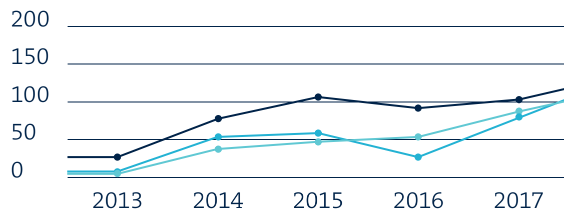


STOCKHOLDER TOTAL RETURN (% CUMULATIVE)

ALRS + *122.25%*

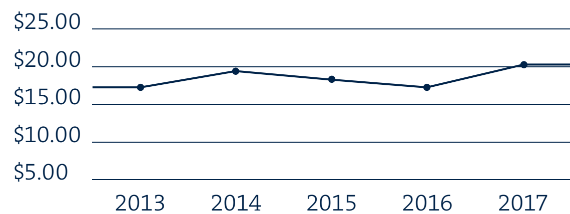
SNL U.S. Financial Services + *109.29%*

S&P 500 + *102.95%*

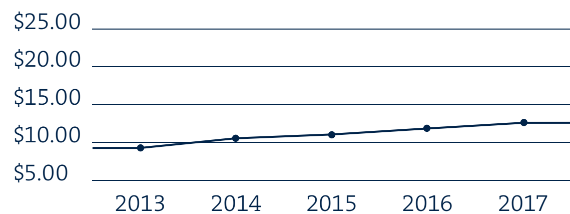


STOCKHOLDER VALUE

Year-End Stock Price



Book Value Per Share



FINANCIAL PERFORMANCE

Reported net income of $15.4 million, up 10.1% from 2016.

Cash dividends per share increased 9.1% from $0.44 per share to $0.48 per share.

Diluted earnings per share of $1.10, up 10.0% from 2016.

Return on average (ROA) assets of 0.77%, up 4 basis points from 2016.

Return on equity (ROE) of 8.74%, up 45 basis points from 2016.

Return on tangible common equity (ROTCE) of 14.30%, down from 14.88% in 2016.

Company revenue of $171.1 million, up 2.4% from 2016.

Business line revenue of $176.8 million, up 3.0% from 2016.

- Banking division revenue of $77.6 million, up 7.9% from 2016.
- Mortgage division revenue of $22.1 million, down 21.6% from 2016.
- Retirement and benefits division revenue of $62.4 million, up 7.9% from 2016.
- Wealth management division revenue of $14.7 million, up 7.6% from 2016.

STRONG CLIENT GROWTH

Total loans grew $207.5 million to $1.57 billion from 2016.

Total deposits grew $49.8 million to $1.83 billion from 2016.

Total assets under administration grew $3.2 billion to $28.2 billion from 2016.

Total assets under management grew $468 million to $3.8 billion from 2016.

CONTINUED STRONG CREDIT QUALITY

Total nonperforming assets decreased $3.2 million or 33.7% from the fourth quarter of 2016; nonperforming assets to total loans plus other nonperforming assets equaled 0.4% at year-end 2017 compared to 0.7% at year-end 2016.

Allowance for loan losses to nonperforming loans was 282% at year-end 2017, compared to 204% at year-end 2016.

MAINTAINED STRONG CAPITAL RATIOS, YEAR-END 2017

Common equity tier 1 ratio of 7.83%.

Tier 1 capital ratio of 8.29%.

Total risk-based capital ratio of 12.17%.

Tier 1 leverage ratio of 7.07%.

CLIENT ENHANCEMENTS

Launched mobile wallet capability making Alerus debit and credit cards usable with Apple Pay® and Samsung Pay®.

Introduced CardValet® fraud mitigation and management tool to enhance debit card security.

Introduced simplified online account access for retirement and health and welfare account holders.

Added online loan statement capability for business banking clients.

Introduced same-day ACH capability within business online banking.

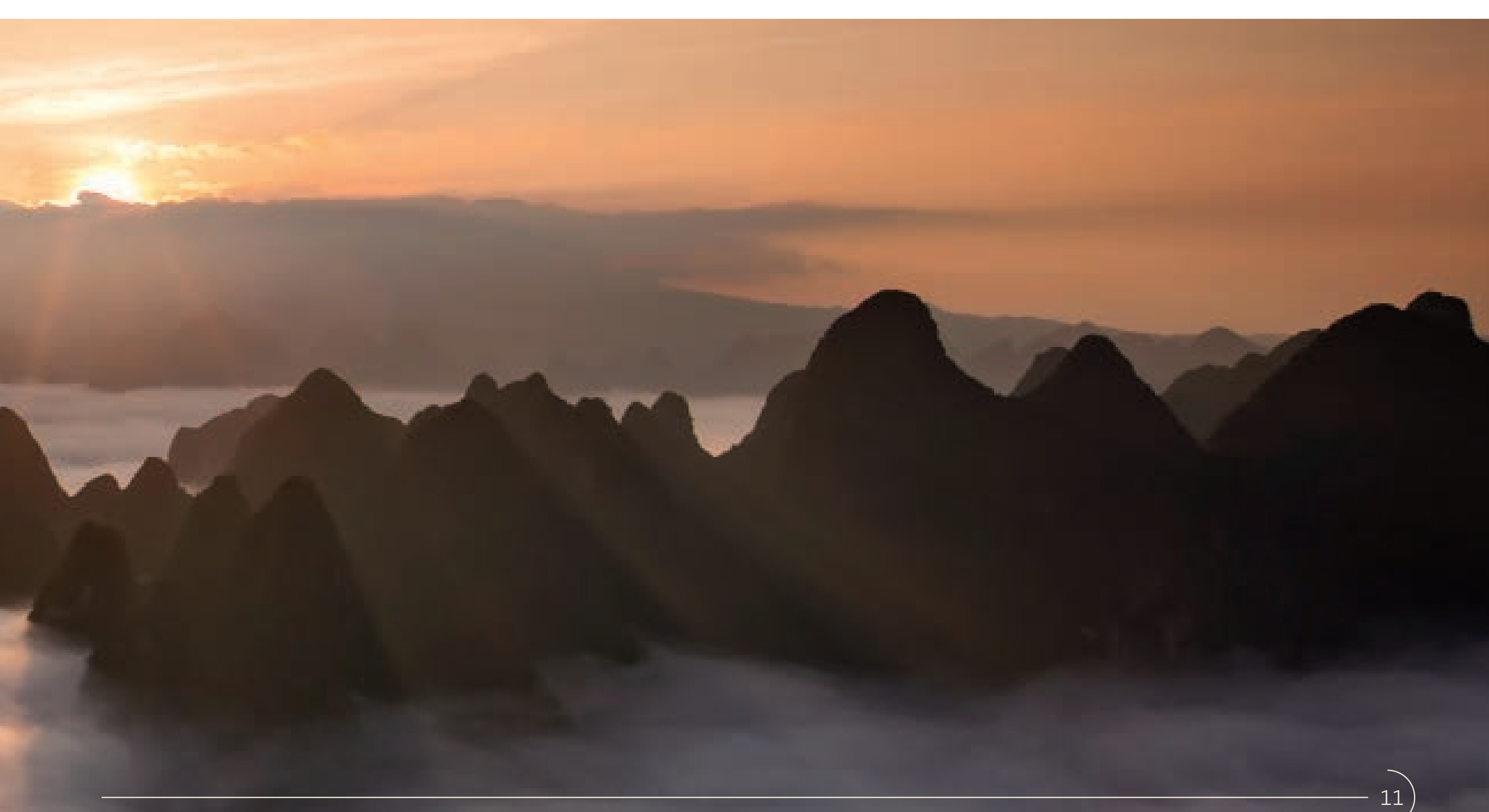
COMPANY DEVELOPMENTS

Reorganized executive management as part of an organizational recommitment to our client-centric strategies.

Executed the transfer to Alerus of $92 million in health savings account deposits previously held by an outside custodian following 2016's acquisition of Alliance Benefit Group North Central States, Inc.

Consolidated and remodeled multiple office locations to better utilize space and support additional staff expansion.

Launched a new investor relations website to provide increased access to company information for current and prospective stockholders.



ACCOMPANYING CLIENTS ON THEIR FINANCIAL JOURNEYS IS A PRIVILEGE THAT WE NEVER TAKE LIGHTLY.

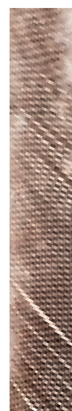
THE DEFINING ASPECT OF THE ALERUS CULTURE IS THE CLIENT-FOCUSED APPROACH WE TAKE TO ALL ASPECTS OF OUR BUSINESS.

EVOLVING WITH CLIENTS

One important feature of One Alerus is an even sharper focus on client-centricity, particularly in light of today's fast-moving technology and the attendant need to deliver products, services, and information on clients' terms. Personal relationships define our service approach. We work with clients when, where, and how they want to be served. For many, it's face to face, but today's clients increasingly seek to engage through websites and mobile apps. Across the industry and among our own client base, we're seeing meaningful growth in the demand for digitally enabled engagement supported by a personal relationship, and we expect this trend to continue.

In 2017 we took a number of steps to position Alerus as a valuable resource for clients, both through technological enhancements and through the alignment and development of employees. We partnered with a leading financial technology company to begin work on a powerful new online account portal that we will introduce over the coming year. Further, we began working with perhaps the world's premier client relationship management software provider to create a platform that will allow our interactions with clients to be more effective, meaningful, and timely.

We were pleased to launch a number of new and upgraded services to help clients manage their day-to-day financial needs. We added our debit and credit cards to Apple Pay® and Samsung Pay™, empowering cardholders to pay quickly and easily with their phones. We introduced CardValet®, a mobile app that adds another layer of security for personal and business debit card users. Business banking clients can now take advantage of same-day ACH service, making their transactions quicker and more efficient. And we simplified the login experience for hundreds of thousands of retirement plan and health savings plan participants. These enhancements are both practical and quietly transformative, because they allow clients to accomplish their tasks more efficiently and safely.



Our organizational model — ***Alerus as a high-value professional services company delivering solutions in the context of a real relationship*** — is about continually finding ways to do things more effectively.

REDEFINING CLIENT EXPERIENCE

Alerus is a diverse financial services company, able to offer a range of solutions and advice that few institutions our size can match. The challenge is to deliver our services cohesively, in ways clients prefer. Our One Alerus strategy seeks to meet this test not only through technology, but through positioning employees to deliver advice and guidance that improves our clients' financial well-being.

This year we focused on defining a service paradigm, centered on advice, designed to provide more than the checking accounts, cash management tools, or retirement services that may have first spurred someone to become a client. We are positioned to add value by providing access to a skilled advisor, someone who can provide guidance on growing a business, securing a comfortable retirement, or any number of other financial goals a client may wish to reach. We are excited to provide more details about this direction in the future.

FOR COMPANY SUCCESS, FOCUS ON THE CLIENT

A business can focus on a host of different things, and to varying degrees at different times. Some focus on competitors, some on technology, some on business models — the list goes on. But at Alerus, we believe the key to success is a clear, unwavering focus on clients. Our advisors are the personification of this belief.

Trusted financial advisors deeply understand their clients, build relationships, and help them identify their goals — both business and personal. Alerus is driven to create remarkable experiences that add value to client relationships. Ultimately, those relationships drive company growth and stockholder value.

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TECHNOLOGY ALONE CANNOT DELIVER A STELLAR CLIENT EXPERIENCE; IT IS WHAT WE DO, HOW WE DO IT, AND WHO DOES IT THAT HELPS US STAND OUT FROM THE CROWD.

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RESHAPING OURSELVES

Working effectively as One Alerus means bringing together a powerful combination of technology and people to better serve clients. On the people side of the equation, 2017 was a year of organizing ourselves in a way that maximizes employees' ability to focus on clients. We began by realigning executive management and making sure the right leaders were put in the right places. As a result, we have seen an even sharper focus on our mission and values, and we are pursuing our goals with renewed vigor.

Organizational changes took place throughout the company as the year progressed. For example, we began working to combine our two customer service call centers into a single unit that will be capable of handling a wider variety of client inquiries and requests. We also combined our information technology and project management areas in order to boost efficiency and streamline processes. Similar actions took place across Alerus and will continue as we seek to empower our employees with the resources they need to perform at their best.

DEVELOPING LEADERS

Discovering and nurturing talent is and will remain a priority for our company. We believe well defined paths to leadership roles for highly skilled employees help us remain an employer of choice in a competitive marketplace. The Alerus Leadership Council, a cross-functional collection of new and established leaders, is one example of such a path. Formed in 2017, this highly collaborative group meets regularly to bring forth fresh ideas and recommendations as to how we can improve the overall client experience, help employees accomplish their work, and ultimately deliver more stockholder value.

We have built our company on the basis of strategic planning for many decades. We believe a similar approach will continue to apply to the evolution of company leadership. Careful evaluation and planning is continually undertaken to ensure that the next generation of board members, executives, and other leaders fits in with the culture we have created, while at the same time allowing these new additions to apply their own experiences, skills, and voices to make Alerus an even better financial services company.

IMPACTING OUR COMMUNITIES

Alerus is powerful not only because of the financial tools and guidance we provide, but also because of the collective contributions we make to the communities in which we live and work. In 2017, Alerus donated approximately $1.4 million to a wide range of difference-making organizations in the communities we serve, including local chambers of commerce, numerous high schools, many arts and cultural programs, and a variety of food shelves. It is a privilege to contribute to many types of organizations that do so much to improve the quality of life of so many people and strengthen the foundation of our communities.

In addition to financial contributions, Alerus donates thousands of hours each year through our employee volunteerism program. Each employee receives paid time off to volunteer in support of the causes and organizations that they hold dear. The impact our employees make in their own communities is as admirable as it is tangible. Moreover, we believe that offering this type of opportunity helps make Alerus a great place to work, helping us attract and retain talent and making us an employer of choice.

WELCOMING OUR NEW CFO

Please welcome our new chief financial officer, Katie Lorenson, who joined Alerus in December.

Ms. Lorenson has held leadership roles at several financial institutions during her career, playing a key role in driving growth and progress. With a deep background in finance, investor relations, capital planning, and market analysis, Ms. Lorenson is an ideal fit for our company as we move forward.

OPERATING AS ONE ALERUS MEANS REFINING OUR TEAMS AND PROCESSES, AND BUILDING AND REINFORCING OUR INFRASTRUCTURE.

IT ALSO MEANS ENHANCING OUR EMPLOYEES' ABILITY TO WORK EFFECTIVELY, ALL FOR THE BENEFIT OF CLIENTS.

CYBERSECURITY REMAINS A MAJOR FOCUS

Continuing a years-long trend, 2017 saw a series of large data breaches at major entities, public and private, reinforcing the need for vigilance when it comes to security in today's tech-driven world. Cybercriminals successfully obtained data ranging from Social Security numbers to purchase histories, shining a light on the vulnerable nature of much sensitive information.

Information security is an operational risk for all financial institutions, which continue to be targets of various evolving and adaptive cyber attacks, including malware and denial of service, as part of elaborate efforts to disrupt operations, test a company's cybersecurity capabilities, or obtain sensitive information about clients and companies.

Addressing cybersecurity risks is a priority for Alerus, and we continue to develop and enhance our controls, processes, and systems in order to protect our networks, computers, software, and data from attack, damage, or unauthorized access. We are also proactively involved in working with others, such as our third-party service providers, to continue to heighten defenses and improve resiliency to cybersecurity threats.

EFFICIENCY AND EFFECTIVENESS

Working together as One Alerus requires effective communication with each other and with clients. To improve our day-to-day interactions internally, we moved to the Microsoft Outlook email platform, upgraded to Cisco's WebEx collaboration and conferencing tools, and continued to expand our corporate intranet. To improve interactions with clients, we invested in a new, world-class customer relationship management tool, or CRM, that we will implement in 2018. This powerful platform will facilitate better relationships by tracking touchpoints and helping us deliver the right solution at the right time.

Process improvements also play a role in making us more efficient and effective. One example was our engagement with a leading finance and technology consulting firm to improve processes in our retirement division. Our retirement area grew rapidly through many acquisitions over the previous decade, which led to a number of challenging and complex processes. Over the course of 18 months, we streamlined operations within the retirement area and positioned ourselves to work better today and to grow in the future.

POSITIONED TO DELIVER

From security to communication, from reporting to technology, the investments we make in operational enhancements enable our entire company to focus on the right things: growing client relationships the right way; further differentiating Alerus in a competitive marketplace; putting our employees in positions to meet client needs; and, finally, enhancing our ability to deliver through high-touch, personal service backed by strong technology.

As we plan for the future, our focus is on optimizing our operations to achieve more efficiencies and improve delivery to clients. Everything from hardware and servers to project management systems to teams of employees will be fine-tuned. This is an open-ended process that demands continued attention and revision in response to competitive pressures, rising client expectations, and rapid industry change.

LOOKING TO THE FUTURE.

The need for thoughtful financial advice is growing. The ways in which that advice is consumed will continue to evolve, and not necessarily in a single direction. Today's financial clients, whether they are business owners or everyday consumers, are expressing a desire for more digital and technological interaction, but at the same time they are voicing their need for financial advice provided by professionals, in person.

Creating business models and solutions that meet these seemingly disparate preferences is not easy, but it is very much worth doing. The entire financial industry continues to remake itself by becoming more strategic about all aspects of their services and how they are provided. Across the country, 2,122 physical bank branches were closed in 2017, largely a product of clients' digital preferences along with a long-term trend toward industry consolidation.

For Alerus, the drive toward a combined personal and digital client experience is both welcomed and expected. Thanks to careful, forward-thinking strategic planning, we have in place a business model designed to meet client needs and to adapt to changing preferences. Clients are at the core of what we do, and the investments we make are designed to make us more effective at meeting them on their terms, and with as little friction as possible. We look forward to many years of building relationships, delivering stockholder value, and making a difference in our clients' lives.

2017 WAS A YEAR THAT RESHAPED OUR COMPANY IN MANY WAYS. OUR STRONG PERFORMANCE AND THOUGHTFUL PLANNING ALLOWED US TO COME TOGETHER AS ONE ALERUS AND UNITE BEHIND THE CONCEPT OF CLIENT EXPERIENCE. WE ARE WELL POSITIONED TO MEET THE GROWING TREND TOWARD COMPREHENSIVE FINANCIAL ADVICE AND TO TAKE ADVANTAGE OF OPPORTUNITIES THAT PRESENT THEMSELVES IN AN EVER-EVOLVING INDUSTRY ENVIRONMENT.

ALERUS LEADERSHIP.

SENIOR EXECUTIVE TEAM

RANDY L. NEWMAN
Chairman, President, and
Chief Executive Officer

37 years with Alerus

KRIS COMPTON
Executive Vice President and
Chief Strategy Officer

43 years with Alerus

DAN J. CHEEVER
Executive Vice President and
Chief Development Officer

3 years with Alerus

ANN MCCONN
Executive Vice President and
Chief Business Officer

16 years with Alerus

KATIE LORENSON
Executive Vice President and
Chief Financial Officer

Joined Alerus in 2017

ALERUS LEADERSHIP COUNCIL

Karl Bollingberg
Director of Lending
31 years with Alerus

Lori Day
Director of Mortgage
Joined Alerus in 2018

Scott Fenske
Ex Officio
General Counsel and
Corporate Secretary
2 years with Alerus

Jon Hendry
Chief Information Officer
34 years with Alerus

Travis Ingebrigtson
Manager of Financial
Planning and Analysis
3 years with Alerus

Chad Johnson, CPA
Ex Officio
Director of Internal Audit
15 years with Alerus

Missy Keney
Director of Marketing and
Customer Experience
13 years with Alerus

Karna Loyland
Director of Deposits
19 years with Alerus

Chip Norris
Group President, Director
of Sales and Service
11 years with Alerus

Brian Overby
President of Retirement
and Benefits
23 years with Alerus

Brian Schumacher
Director of Wealth
Management
7 years with Alerus

Teresa Wasvick
Director of Human Resources
27 years with Alerus

BOARD OF DIRECTORS

Randy L. Newman
Grand Forks, ND

Chairman, President, and Chief Executive Officer, Alerus Financial, N.A., Alerus Financial Corporation

Karen M. Bohn
Edina, MN

President, Galeo Group, LLC

Former Chief Administrative Officer, Piper Jaffray Companies

Former Chief Executive Officer, Piper Trust Company

Lloyd G. Case
Fargo, ND

Past President and CEO of Forum Communications Company

Board of Directors, Forum Communications

Daniel E. Coughlin
Chicago, IL

Former Managing Director and Co-Head of Financial Services, Raymond James & Associates

Former Chairman and CEO, Howe Barnes Hoefer & Arnett

Harold A. Gershman
Grand Forks, ND

President, Gershman Enterprises, LLC

President, Happy Harry's Bottle Shops

James J. Karley
Gilby, ND

President, Johnstown Bean, Cavalier Bean Companies, and North Central Commodities

Kevin D. Lemke
Grand Forks, ND

President, Virtual Systems, Inc.

Sally Smith
Minneapolis, MN

Retired President and Chief Executive Officer, Buffalo Wild Wings, Inc.

Galen G. Vetter
Minneapolis, MN

Former Global Chief Financial Officer, Franklin Templeton Investments

Former Partner-in-Charge, Upper Midwest Region, McGladrey

MARKET PRESIDENTS

Chris Wolf, CPA, Grand Forks
8 years with Alerus

Dan Doeden, Fargo
14 years with Alerus

Sara Ausman, Twin Cities
6 years with Alerus

Deb Otto, Duluth
2 years with Alerus

Rob Schwister, Phoenix
8 years with Alerus

TWIN CITIES ADVISORY BOARD

Hillary Feder
Hillary's

Larry Gamst
Franklin Partners, Inc.

Julie Gilbert
PreciouStatus

Larry Lautt
Great West Ventures, LLC

Lisa Meyer
Marketing and Management Executive

Dennis Monroe
Monroe Moxness Berg PA

James Nichols
James L. Nichols CPA, LLC

Julie Tanaka
Compendium Capital Group
Compendium Business Strategies, LLC

A HISTORY OF GROWTH.

1879	Founded as the Bank of Grand Forks, one of the first chartered in the Dakota Territory.
1933	First National Bank in Grand Forks opened its doors in Grand Forks, North Dakota.
1985	Acquired Northwood State Bank in Northwood, North Dakota.
1986	Created Employee Stock Ownership Plan for our employees.
1987	Entered the Fargo market by purchasing West Fargo State Bank in West Fargo, North Dakota.
1989	Purchased Dakota Bank in Grand Forks, North Dakota.
1991	First National Bank in Grand Forks purchased the North Dakota branches of First Federal Savings & Loan in Fargo, North Dakota, and changed its name to First National Bank North Dakota.
1997	Historic flood and fire devastated Grand Forks and First National Bank North Dakota's buildings.
2000	First National Bank North Dakota changed its name to Alerus Financial to reflect the evolution from a traditional bank to a diversified financial services company.
2002	Acquired a branch of BNC National Bank in Fargo, North Dakota.
2003	Purchased Pension Solutions, Inc., a retirement plan services company located in St. Paul, Minnesota.
2006	Opened a trust and investment office in the Twin Cities; purchased Stanton Trust Company in Minneapolis, Minnesota.
2007	Opened a business banking office in Minnetonka, Minnesota; purchased the retirement recordkeeping services unit of Acclaim Benefits, Inc. in Minneapolis, Minnesota; acquired Stanton Investment Advisors, Inc., a Minneapolis-based investment advisory firm.
2009	Expanded into Phoenix, Arizona; purchased the retirement plan practice of Eide Bailly, LLP in Minneapolis, Minnesota; acquired deposits from BankFirst in Minneapolis, Minnesota; acquired Prosperan Bank in Oakdale, Maplewood, and Minnetonka, Minnesota; acquired Residential Mortgage Group in Minnetonka and Arden Hills, Minnesota.
2011	Acquired a branch in Arizona and selected loans and deposits in Minnesota and Arizona from BNC National Bank in Scottsdale, Arizona.
2012	Purchased PensionTrend Inc., and PensionTrend Investment Advisers, LLC, in Okemos, Michigan.
2013	Purchased Tegrit Administrators, LLC.
2014	Purchased Private Bank Minnesota in Minneapolis, Minnesota; purchased Retirement Alliance, Inc., in Manchester, New Hampshire.
2015	Purchased Interactive Retirement Systems, LTD, in Bloomington, Minnesota.
2016	Purchased Beacon Bank in Shorewood, Excelsior, Eden Prairie, and Duluth, Minnesota; purchased Alliance Benefit Group North Central States, Inc., in Albert Lea and Eden Prairie, Minnesota.

ALERUS

BANKING :: MORTGAGE :: RETIREMENT :: WEALTH MANAGEMENT

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FINANCIAL REPORT

ALERUS
FINANCIAL CORPORATION

TABLE 1 – SELECTED FINANCIAL DATA
Year ended December 31,
(dollars in thousands, except per share amounts)

	2017	2016	2015	2014	2013
Income Statement Data					
Interest income	$ 75,637	$ 69,942	$ 56,328	$ 54,394	$ 50,510
Interest expense	7,967	7,002	3,458	3,316	3,712
Net interest income	67,670	62,940	52,870	51,078	46,798
Provision for loan losses	3,280	3,060	4,200	(400)	1,200
Net interest income, after provision for loan losses	64,390	59,880	48,670	51,478	45,598
Noninterest income	103,459	105,081	93,255	78,406	79,269
Noninterest expense	134,920	143,792	118,134	100,115	92,913
Income before income taxes	32,929	21,169	23,791	29,769	31,954
Income tax expense	17,485	7,138	6,683	8,999	11,417
Net income	$ 15,444	$ 14,031	$ 17,108	$ 20,770	$ 20,537
Diluted earnings per common share	$ 1.10	$ 1.00	$ 1.21	$ 1.48	$ 1.48
Performance Ratios					
Net interest margin	3.76%	3.63%	3.81%	3.97%	3.94%
Return on average total assets	0.77%	0.73%	1.12%	1.45%	1.57%
Return on average common equity	8.74%	8.29%	10.51%	14.26%	15.60%
Return on average tangible common equity	14.30%	14.88%	13.41%	17.11%	18.23%
Efficiency ratio	78.84%	85.50%	80.84%	77.32%	73.70%
Balance Sheet Data					
Cash and due from banks	$ 121,998	$ 207,367	$ 266,159	$ 45,526	$ 72,544
Investment securities	274,411	278,911	192,343	206,101	279,672
Loans held for sale	17,938	35,063	48,642	35,042	30,254
Loans	1,574,474	1,366,952	1,126,921	1,095,458	914,564
Allowance for loan losses	(16,564)	(15,615)	(14,688)	(17,063)	(16,838)
Goodwill	27,329	27,329	3,683	3,264	664
Other intangible assets	31,797	37,506	21,751	22,442	15,014
Total assets	2,137,058	2,050,579	1,744,863	1,487,732	1,381,727
Deposits	1,834,962	1,785,209	1,458,021	1,262,168	1,182,603
Long-term debt	58,819	58,813	70,744	21,494	21,630
Total liabilities	1,956,487	1,881,794	1,562,042	1,316,646	1,228,416
Common stockholders' equity	180,571	168,785	162,821	151,086	133,311
Total stockholders' equity	180,571	168,785	182,821	171,086	153,311
Capital					
Common equity tier 1	7.8%	7.7%	10.9%	N/A	N/A
Tier 1 capital	8.3%	8.2%	12.3%	11.8%	12.8%
Total capital	12.2%	12.3%	17.0%	13.0%	14.1%
Tier 1 leverage	7.1%	6.9%	10.9%	10.1%	10.6%
Tangible common equity / tangible assets	6.1%	5.5%	8.2%	8.8%	8.8%
Asset Quality					
Nonperforming assets	$ 6,356	$ 9,581	$ 12,028	$ 6,484	$ 10,265
OREO	446	1,721	842	2,478	4,877
Nonperforming assets / loans and other real estate	0.40%	0.70%	1.07%	0.59%	1.12%
Net (charge-offs) recoveries / average total loans	0.16%	0.16%	0.58%	-0.06%	-0.06%
Allowance for loan losses / total loans	1.05%	1.14%	1.30%	1.56%	1.84%
Allowance for loan losses / nonperforming loans	282.04%	203.74%	131.72%	427.11%	313.15%
Other					
Assets under management	$ 3,848,085	$ 3,379,787	$ 2,734,850	$ 2,583,808	$2,424,642
Assets under administration	28,220,246	25,028,090	17,459,308	15,518,303	12,860,780
Mortgage originations	867,253	1,065,132	986,979	729,913	1,028,208

ABOUT ALERUS FINANCIAL CORPORATION

Alerus Financial Corporation (the "Company") is a diversified financial services company with $2.1 billion in banking assets, $3.8 billion of assets under management and $28.2 billion of assets under administration. The Company, through its subsidiaries Alerus Financial, N.A. (the "Bank") and Alerus Securities Corporation, offers business and consumer banking products and services, residential mortgage financing, wealth management services including trust, brokerage, executive insurance, and asset management, and employer-sponsored retirement plan administration and employer sponsored services including payroll, health savings accounts, flexible spending accounts, health reimbursement arrangements, and COBRA administration. The Company's banking and wealth management offices are located in Grand Forks and Fargo, North Dakota, the Minneapolis-St. Paul and Duluth, Minnesota metropolitan areas, and Scottsdale, Arizona. Alerus Retirement and Benefits administers plans in all 50 states through offices located in St. Paul and Albert Lea, Minnesota, East Lansing and Troy, Michigan, and Bedford, New Hampshire. The common stock of the Company trades on the OTCQX market under the symbol ALRS.

RECENT EVENTS

ACQUISITIONS

During the two years ended December 31, 2017, the Company completed the following acquisitions:

Beacon Bank

On January 15, 2016, the Company acquired Beacon Bank and its five branches, three located in the southwestern suburbs of Minneapolis, Minnesota, and two in Duluth, Minnesota. The Company assumed $327.4 million of deposits and other liabilities, including $10.0 million of trust preferred securities, and purchased $350.6 million in cash, securities, loans, and other assets. As part of the transaction, the Company allocated $18.8 million to goodwill and $3.8 million to a core deposit intangible. The core deposit intangible is being amortized over the estimated life of five years, resulting in an annualized intangible amortization expense of $759 thousand, while the goodwill is not subject to amortization.

Alliance Benefit Group North Central States, Inc. (ABGNCS)

On January 1, 2016, the Company acquired Alliance Benefit Group North Central States, Inc. (ABGNCS), with locations in Albert Lea and Eden Prairie, Minnesota. The purchase, consisting of approximately 900 retirement plans with more than 75,000 retirement participants, grew the Company's retirement division by $6.0 billion in retirement and individual asset managed accounts. As part of the transaction, $4.8 million was allocated to goodwill and $17.9 million to an identified customer intangible, based on the estimated value as of the acquisition date. The identified customer intangible is being amortized over the estimated life of ten years, resulting in an annualized intangible amortization expense of $1.8 million, while the goodwill is not subject to amortization.

SMALL BUSINESS LENDING FUND PREFERRED STOCK

On February 16, 2016, Alerus redeemed $20.0 million of Small Business Lending Fund (SBLF) preferred stock, which had been outstanding since August 8, 2011. The SBLF had a dividend rate of 1.0 percent that was scheduled to reset to 9.0 percent on February 18, 2016. The SBLF qualified as Tier 1 capital for regulatory purposes.

OFFICE CONSOLIDATIONS

In August 2016, the Company announced the closure and consolidation of three branch offices, two in Fargo, North Dakota, and one in Maplewood, Minnesota, effective November 23, 2016. The loans and deposits of the offices were consolidated into other Bank offices within close proximity in those markets. The cost of closing these facilities was $1.5 million and was recorded in 2016, with an additional $0.5 million of expenses relating to the sale of one of the offices recorded in 2017. The Company has continued to consolidate other facilities, either acquired through acquisitions or leased by the Company, to reduce operating expenses and improve efficiencies. During 2016, the Company vacated three leased facilities, consolidating operations units into other locations. In the first quarter of 2017, two additional locations were also vacated as leases expired.

INCOME TAXES

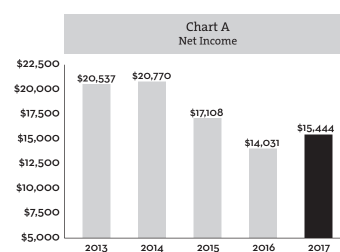
On December 22, 2017, the U.S. Government enacted the Tax Cuts and Jobs Act (TCJA) which reduced the corporate income tax rate from 35% to 21%. The Company was required to adjust the carrying value of deferred tax assets and liabilities using the new tax rate, which will be effective in 2018. This resulted in a charge to earnings in the fourth quarter of 2017 of $4.6 million which is included in income tax expense on the consolidated statements of income. The lower income tax rate is expected to benefit the Company in future periods. In June 2017, the Company recorded additional income tax expense of $1.4 million related to the impairment of a deferred tax asset recorded as part of the Private Bank Minnesota acquisition in 2014. The recording of these deferred tax charges increased the Company's effective tax rate to 53.1% in 2017 from 33.7% in 2016.

FINANCIAL PERFORMANCE

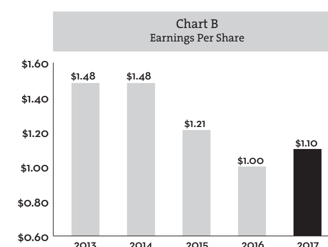
The following is management's discussion and analysis of the significant changes in the results of operations, capital resources, and liquidity presented in the accompanying consolidated financial statements. The Company's consolidated balance sheet and income statement are comprised primarily of the financial condition and results of operations of the Bank. Current performance does not guarantee, and may not be indicative of, similar performance in the future. For more information on the factors that could affect performance, see "Forward Looking Statements."

EARNINGS SUMMARY

Net income was $15.4 million or $1.10 diluted earnings per common share in 2017, compared to $14.0 million or $1.00 diluted per share for 2016, and $17.1 million or $1.21 diluted per share for 2015. The Company's financial performance in 2017 includes the recording of $6.0 million additional income tax expense related to deferred tax assets, $4.6 million related to the re-measurement of the deferred tax assets as a result of the Tax Cuts and Jobs Act of 2017 and $1.4 million related to the Private Bank Minnesota acquisition in 2014. Also in 2017, the Company incurred $1.6 million of nonrecurring professional fees related to litigation and $0.5 million of additional expense related to branch closures. In 2016, the Company incurred $6.7 million of nonrecurring expenses as follows: $4.0 million incurred in the acquisitions of ABGNCS and Beacon Bank, $1.5 million related to the closure of three branch offices, $0.4 million for prepayment fees on FHLB advances and $0.8 million of other expenses. The Company's 2017 earnings also reflect $5.6 million of amortization of identified intangibles from acquisitions, which lower earnings per share, net of taxes, by $0.24, compared to $7.0 million or $0.30 per share in 2016. The net income and earnings per share over the last five years are illustrated in **Charts A** and **B**, respectively.



The Company reported record pretax earnings of $32.9 million in 2017, an increase of $11.8 million, or 53.5% from the $21.2 million reported in 2016 and the $23.8 million in 2015. The impact of the deferred tax charges set forth above, and higher pretax earnings, increased the Company's income tax expense from $7.1 million in 2016 to $17.5 million in 2017, reducing reported net income to $15.4 million.



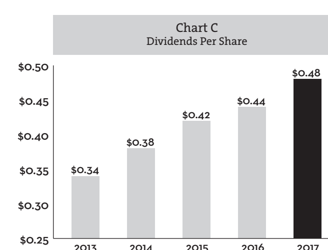
Revenue, the sum of net interest income and noninterest income, was $171.1 million in 2017, compared with $168.0 million in 2016, and $146.1 million in 2015. The Company's diversified revenue model continues to generate strong core earnings, reflecting revenue growth in the banking, retirement and benefit, and wealth management business lines, while mortgage revenues declined due to lower volumes of originations and sales. The increase in revenue for 2017 was primarily as a result of an increasing loan portfolio and increasing assets under administration and assets under management. The increase in revenue for 2016 compared to 2015 was predominantly due to the acquisitions of Beacon Bank and ABGNCS, and higher mortgage originations.

Net interest income was $67.7 million in 2017, representing 39.5% of revenue, compared to $62.9 million, or 37.5% of revenue, in 2016, and $52.9 million, or 36.2% of revenue, in 2015. The net interest income increase in 2017 was primarily due to an increasing loan portfolio, while the increase in 2016 was the result of the acquisition of Beacon Bank in January 2016.

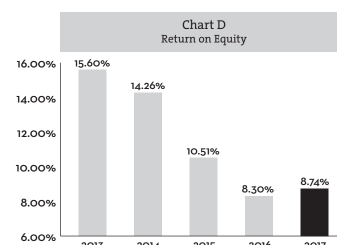
Noninterest income was $103.5 million in 2017, representing 60.5% of revenue, compared to $105.1 million or 62.5% of revenue in 2016, and $93.3 million, or 63.8% of revenue, in 2015. The decrease in noninterest income in 2017 was the result of lower mortgage banking revenue, which decreased 26.8%, as a result of lower origination production, lower sales, and retention of mortgage loans for portfolio. Retirement and benefits and wealth management noninterest income increased 7.7% and 11.8% respectively, as assets under administration and management increased during the year.

Noninterest expense was $134.9 million in 2017, compared with $143.8 million in 2016, and $118.1 million in 2015. The decrease in noninterest expense in 2017, compared to 2016, reflected lower personnel, occupancy, intangible amortization, and other operating expenses, which were all higher in 2016 as a result of the acquisitions of ABGNCS and Beacon Bank.

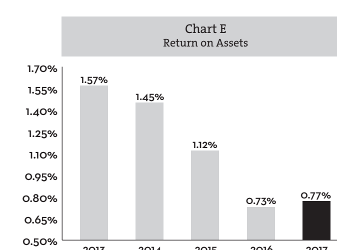
Cash dividends per common share were $0.48 in 2017, compared to $0.44 in 2016, and $0.42 in 2015. The growth in cash dividends per share over the last five years is illustrated in **Chart C**.



Return on Average Common Equity (ROE) is net income stated as a percentage of average common stockholders' equity. ROE was 8.74% in 2017, compared to 8.29% in 2016, and 10.51% in 2015, as further illustrated in **Chart D**. The average ROE over the past five years is 11.48%.



Return on Average Assets (ROA) is net income stated as a percentage of average total assets. As **Chart E** illustrates, ROA was 0.77% in 2017, compared to 0.73% in 2016, and 1.12% in 2015. The average ROA over the past five years is 1.13%.

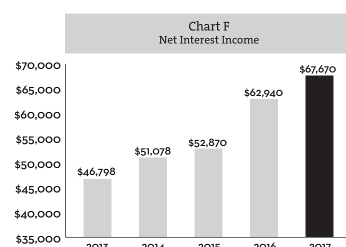


NET INTEREST INCOME

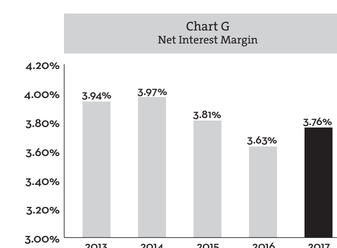
Net interest income is the interest earned on investment securities, loans (including yield-related loan fees) and other interest-earning assets minus the interest paid for deposits, short-term borrowings, and long-term debt. Net interest margin is the average yield on earning assets minus the average interest rate paid for deposits and other sources of funding. Net interest income and net interest margin are presented on a taxable-equivalent basis in **Table 2** to consistently reflect income from taxable and tax-exempt loans and securities based on a 35.5% marginal income tax rate.

While the Company believes that it has the ability to increase net interest income over time, net interest income and net interest margin in any one period can be significantly affected by a variety of factors, including the mix and overall size of our earning asset portfolio and the cost of funding those assets.

Interest income was $75.6 million in 2017, an increase of $5.7 million, or 8.1%, from the $69.9 million reported in 2016 and the $56.3 million reported in 2015. The increase in interest income for 2017, compared with 2016, was largely driven by higher average loans outstanding, $1.48 billion versus $1.35 billion at a slightly lower average yield: 4.62% versus 4.65%. Average earning assets increased to $1.82 billion from $1.75 billion in 2016 and the average yield increased from 4.03% to 4.19%. The increase in interest income from 2015 to 2016 was due to the acquisition of Beacon Bank, which increased both the loans outstanding and average yield on the portfolio. Average earning assets increased by $350.5 million to $1.75 billion in 2016; however the average yield decreased to 4.03% from 4.06% in 2015, as a result of a larger investment portfolio at lower yields.



In 2017 the average interest bearing liabilities increased by $13.5 million to $1.31 billion, with an average rate of 0.61%, as compared to 0.54% in 2016, as a result of the increase in short-term borrowings utilized to fund growth in the loan portfolio, prior to the conversion of $92.5 million of Health Savings Account (HSA) deposits, in the fourth quarter of 2017. In the acquisition of ABGNCS, the Company acquired an HSA administration business line, which included deposits that were in the custody of another financial institution. These deposits were transferred to the Company during the fourth quarter of 2017. Average noninterest bearing deposits increased to $488.3 million in 2017, from $443.5 million in 2016.



Core deposits are an important low-cost source of funding and affect both net interest income and net interest margin. Core deposits include noninterest-bearing deposits, interest-bearing checking, certificates of deposit less than $250 thousand, and money market savings deposits. Core deposits increased to $1.81 billion at December 31, 2017, an increase of $57.1 million from the $1.75 billion in 2016. Net interest margin was 3.76% in 2017, up 13 basis points from 3.63% in 2016, and comparable to the 3.81% in 2015.

Chart F illustrates net interest income on a tax equivalent basis for the past five years.

Chart G illustrates net interest margin for the past five years.

TABLE 2 – AVERAGE BALANCE SHEETS AND AVERAGE RATES
Year ended December 31,
(Dollars in thousands)

	2017			2016			2015		
	Average Balance	Average Rate	Interest	Average Balance	Average Rate	Interest	Average Balance	Average Rate	Interest
Assets									
Interest-bearing deposits with banks	$ 39,045	0.97%	$ 379	$ 84,667	0.51%	$ 429	$ 48,273	0.25%	$ 123
Federal funds sold	-	0.00%	-	654	0.15%	1	95	0.00%	-
Investment securities (a)	286,313	2.52%	6,459	279,992	2.31%	5,868	183,103	2.69%	4,474
Loans held for sale	23,887	2.55%	609	39,583	2.91%	1,152	43,515	3.24%	1,409
Loans									
Commercial									
Commercial and industrial (a)	449,901	4.76%	21,314	444,637	4.56%	20,268	383,098	4.58%	17,526
Real estate construction	44,492	5.04%	2,243	39,423	5.06%	1,996	34,772	4.15%	1,442
Real estate mortgage	418,275	4.68%	19,592	364,134	4.93%	17,958	257,110	4.65%	11,963
Farmland and agricultural	46,413	4.47%	2,075	50,375	4.19%	2,109	55,067	4.18%	2,300
Total commercial(a)	959,081	4.72%	45,224	898,569	4.71%	42,331	730,047	4.55%	33,231
Consumer									
Real estate 1-4 family first mortgage	243,655	4.29%	10,464	182,038	4.34%	7,899	155,137	4.42%	6,862
Real estate 1-4 family junior mortgage	188,420	4.79%	9,026	177,431	5.03%	8,922	159,772	4.82%	7,700
Automobile	57,426	3.29%	1,890	59,832	3.06%	1,833	59,982	2.92%	1,753
Other revolving and installment	26,460	5.99%	1,586	27,339	5.51%	1,507	19,663	3.95%	776
Total consumer	515,961	4.45%	22,966	446,640	4.51%	20,161	394,554	4.33%	17,091
Total loans (a)	1,475,042	4.62%	68,190	1,345,209	4.65%	62,492	1,124,601	4.48%	50,322
Total earning assets (a)	1,824,287	4.19%	75,637	1,750,105	4.03%	69,942	1,399,587	4.06%	56,328
Cash and due from banks	26,190			28,186			23,676		
Allowance for loan losses	(15,818)			(15,937)			(17,218)		
Goodwill & other intangibles	61,843			64,111			28,093		
Premises and equipment	22,929			25,519			21,375		
Other assets	81,611			82,211			77,884		
Total assets	$2,001,042			$1,934,195			$1,533,397		
Liabilities and Stockholders' Equity									
Savings, checking, and money market deposits	$ 956,563	0.21%	$ 2,035	$ 971,979	0.18%	$ 1,767	$ 743,237	0.15%	$ 1,106
Certificates of deposit	219,164	0.68%	1,485	251,359	0.64%	1,618	225,096	0.73%	1,652
Short-term borrowings	72,445	1.30%	943	5,059	0.42%	21	12,599	0.25%	32
Long-term debt	58,803	5.96%	3,504	65,102	5.52%	3,596	23,480	2.84%	668
Total interest bearing liabilities	1,306,975	0.61%	7,967	1,293,499	0.54%	7,002	1,004,412	0.34%	3,458
Noninterest-bearing deposits	488,295			443,453			327,654		
Other liabilities	28,994			28,501			20,400		
Stockholders' equity	176,778			168,742			180,931		
Total liabilities and stockholders' equity	$2,001,042			$1,934,195			$1,533,397		
Net interest margin/income (a)		3.76%	$ 67,670		3.62%	$62,940		3.81%	$52,870
Interest rate spread (a)		3.58%			3.49%			3.71%	

(a) Taxable equivalent adjustment was calculated utilizing a marginal income tax rate of 35.5 percent

The Company manages the balance sheet to be interest rate neutral to slightly asset sensitive, defined as allowing assets on the balance sheet to reprice faster than the liabilities that fund them. Financial institutions will feel additional pressure on net interest margin the longer short-term rates remain at lower levels since there is limited opportunity to reprice deposits and fixed-rate loans mature or renew at lower rates. The Company actively implements risk management strategies as detailed in the "Interest Rate Risk" discussion to minimize the effects of interest rate volatility.

Table 2 presents detailed information as to average balances, interest income and expense, and rates earned and paid by major balance sheet categories for the years 2015 through 2017. **Table 3** provides an analysis of the change in net interest income that is attributable to changes in volume of interest-earning assets or interest-bearing liabilities, and to changes in rates earned and paid.

TABLE 3 – VOLUME AND RATE VARIANCE ANALYSIS
Year ended December 31,
(Dollars in thousands)

	Year 2017 to 2016 Change Due to			Year 2016 to 2015 Change due to		
	Volume	Rate	Total	Volume	Rate	Total
Interest income						
Interest bearing deposits with banks	$ (231)	$ 181	$ (50)	$ 93	$ 213	$ 306
Federal funds sold	(1)	-	(1)	-	1	1
Investment securities	146	445	591	2,602	(1,208)	1,394
Loans held for sale	(457)	(86)	(543)	(127)	(130)	(257)
Loans						
Commercial						
Commercial and industrial	240	806	1,046	2,819	(77)	2,742
Real estate construction	257	(10)	247	193	361	554
Real estate mortgage	2,670	(1,036)	1,634	4,980	1,015	5,995
Farmland and agricultural	(166)	132	(34)	(196)	5	(191)
Total commercial	3,001	(108)	2,893	7,796	1,304	9,100
Consumer						
Real estate 1-4 family first mortgage	2,674	(109)	2,565	1,190	(153)	1,037
Real estate 1-4 family junior mortgage	553	(449)	104	851	371	1,222
Automobile	(74)	131	57	(4)	84	80
Other revolving and installment	(48)	127	79	303	428	731
Total consumer	3,105	(300)	2,805	2,340	730	3,070
Total loans	6,106	(408)	5,698	10,136	2,034	12,170
Total interest income	5,563	132	5,695	12,704	910	13,614
Interest expense						
Savings, checking, and money market deposits	(28)	296	268	340	321	661
Certificates of deposit	(207)	74	(133)	193	(227)	(34)
Short term borrowings	280	642	922	(19)	8	(11)
Long term debt	(348)	256	(92)	1,184	1,744	2,928
Total interest expense	(303)	1,268	965	1,698	1,846	3,544
Increase (decrease) in net interest income	$ 5,866	$(1,136)	$ 4,730	$11,006	$ (936)	$10,070

PROVISION FOR LOAN LOSSES

The allowance for loan losses (allowance) is an estimate of losses inherent in the Company's loan portfolios and is established through a regular provision for loan losses (provision) based on historical losses incurred on similar pools of loans and periodic analysis of the portfolios' credit quality, as well as economic and business conditions. Provisions are expected in order to maintain the adequacy of the total allowance after loan losses and recoveries, loan growth, and changes in management's assessment of credit quality and estimates of probable loan losses. Loan losses are charged-off against the allowance when the Company determines the loan balance to be uncollectible. Cash received on previously charged-off amounts is recorded as a recovery to the allowance. Annual fluctuations in the provision result from management's regular assessment of the adequacy of the allowance based on the factors described above.

The provision for 2017 was $3.3 million compared to $3.1 million during 2016, increasing the allowance from $15.6 million in 2016 to $16.6 million in 2017, net of charges to the allowance. Asset quality has continued to improve, with nonperforming assets decreasing from $9.6 million at December 31, 2016, to $6.4 million at December 31, 2017. The ratio of nonperforming assets to loans and other real estate at year-end 2017 was 0.40%, compared to 0.70% in 2016. The ratio of the end-of-year balance of the allowance to end-of-year loans was 1.05% for 2017, compared to 1.14% for 2016. Average loans were $1.48 billion in 2017, an increase of $129.8 million, or 9.7%, from the $1.35 billion reported in 2016. The amount of provision to be taken in future periods will depend on management's assessment of the adequacy of the allowance in relation to the loss experience of the entire loan portfolio and periodic analysis of the portfolio's credit quality and economic and business conditions.

The Company's banking assets are distributed across eastern North Dakota, Minneapolis-St. Paul, and Duluth, Minnesota, and the Phoenix, Arizona metropolitan area, with minimal exposure, less than 1.5% of loans, to the western North Dakota oil-related areas.

NONINTEREST INCOME

The Company continues to expand noninterest income associated with the Company's banking, mortgage, retirement and benefit services, and wealth management divisions. The Company's primary sources of noninterest income consist of retirement plan and recordkeeping services, trust and investment services, loan fees, and net gains on mortgage loan origination and sales activities. Noninterest income of $103.5 million represented 60.5% of revenue for 2017 compared with $104.2 million, or 62.5% of revenue, for 2016, and $93.3 million, or 63.8% of revenue, for 2015. The decrease in noninterest income in 2017 was due to decreased mortgage banking revenue from lower originations and sales. **Table 4** provides a summary of changes in noninterest income the past three years.

Retirement and benefit services, which includes retirement plan administration, retirement plan investment advisory, payroll, HSA, and other benefit services is the Company's largest source of noninterest income, reporting noninterest income of $62.2 million in 2017, a $4.4 million, or 7.7% increase, from the $57.8 million reported in 2016. A majority of retirement services fees are transaction or participant based plan fees, with the remainder based on the market value of assets under administration. At December 31, 2017, assets under administration totaled $28.2 billion, up $3.2 billion, or 12.8%, from $25.0 billion at December 31, 2016.

Wealth management noninterest income, which includes personal trust services and investment services offered by the Bank and Alerus Securities was $14.1 million, a $1.5 million, or 11.6%, increase from the $12.6 million reported in 2016. The Company earns trust, investment, and individual retirement account fees from managing and administering assets, including mutual funds, corporate trusts, personal trusts, and separately managed accounts. Trust and investment fees are primarily based on a tiered scale relative to the market value of the assets under management. At December 31, 2017, assets under management totaled $3.8 billion, up $0.5 billion, or 13.8%, from the $3.4 billion reported in 2016.

Mortgage banking noninterest income, consisting of net servicing income and net gains on loan origination and sales activities, totaled $20.7 million in 2017, a $7.6 million, or 26.8%, decrease from the $28.3 million reported in 2016. The Company's mortgage division originated $876.3 million in loans in 2017, a $197.9 million, or 18.6%, decrease from the $1.1 billion in loans originated in 2016. The Company retained on balance sheet $176.5 million of mortgage loans in 2017 as compared to $48.7 million in 2016, which reduced the net gains on loan sales. The Company's mix of refinance and home purchase mortgage originations increased from 68% home purchase in 2016 to 80% home purchase in 2017.

TABLE 4 – NONINTEREST INCOME
Year ended December 31,
(dollars in thousands)

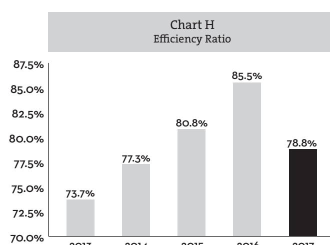
	2017	2016	2015	% Increase/ decrease 2017/2016	% Increase/ decrease 2016/2015
Retirement services	$ 62,234	$ 57,804	$51,059	7.66%	13.21%
Wealth management	14,109	12,640	11,418	11.62%	10.70%
Mortgage banking	20,700	28,296	24,630	-26.84%	14.88%
Service charges on deposit accounts	1,854	1,916	1,611	-3.24%	18.93%
Investment security gains (losses)	(13)	(24)	(17)	45.83%	41.18%
Other noninterest income	4,575	4,449	4,554	2.83%	-2.31%
Total noninterest income	$103,459	$105,081	$93,255	-1.54%	12.68%
Noninterest income as a % of revenue	60.46%	62.54%	63.82%	-3.33%	-2.00%

NONINTEREST EXPENSE

Total noninterest expense was $134.9 million in 2017, an $8.8 million, or 6.2%, decrease from the $143.8 million reported in 2016. Operating expenses decreased in 2017 as the previous year included $6.7 million of nonrecurring operating expenses related to the acquisitions of ABGNCS and Beacon Bank. Additionally, intangible amortization expense decreased from $7.0 million in 2016 to $5.6 million in 2017.

The Company's efficiency ratio, defined as the percent of noninterest expense to total revenue, improved to 78.8% in 2017, from 85.5% in 2016.

Chart H illustrates the trend in the efficiency ratio over the last five years.



While control of noninterest expense is a priority for management, the higher-than-average efficiency ratio is partially due to the Company generating 60.5% of total revenue from noninterest income sources. The efficiency ratio for a business comprised primarily of net interest margin income is generally lower than a diversified financial services company, comprised primarily of asset management and administration income and mortgage origination income.

Personnel expenses, which include salaries, commissions, incentive compensation, and employee benefits, are the largest expense component for the Company, representing 62.3% of noninterest expenses in 2017 and 60.3% in 2016. Salary expense was $67.6 million in 2017 as compared to $70.7 million in 2016, a decrease of $3.2 million or 4.5% over 2016. Employee benefit costs were $16.5 million in 2017, a $0.5 million, or 3.2%, increase from the $16.0 million reported in 2016. The decrease in salaries and incentives was a result of lower mortgage incentive payments due to lower originations, as well as fewer employees following the integration of the Company's prior acquisitions.

Occupancy expense was $6.3 million in 2017, a $0.1 million decrease from the $6.4 million reported in 2016. Furniture and equipment expense was $5.6 million in 2017, reflecting a 7.5% decrease from the $6.0 million reported in 2016. The decrease in occupancy and furniture and equipment expenses is primarily the result of the closure of three branch offices in 2016 and the consolidation of office space accumulated in previous acquisitions.

The Company has acquired 18 companies since 2002 for an aggregate premium of $88.1 million in excess of book value, creating identified intangible assets of $60.7 million and $27.3 million in goodwill on the balance sheet. The identified intangible assets amortize for book purposes and are reported in other noninterest expense. Goodwill is evaluated annually for impairment and does not amortize for book purposes. The amortization schedules vary based on the type and quality of the acquisition. The aggregate unamortized intangible balance as of December 31, 2017, is $27.1 million, which will fully amortize by December 31, 2025. The intangible amortization expense for 2017 was $5.6 million, compared to $7.0 million in 2016, a 19.7% decrease, as a result of past acquisitions being fully amortized during the year.

As the acquisitions were integrated and efficiencies realized, a number of operating expenses were reduced from the levels incurred in 2016. Supplies, telephone and postage expenses were reduced 18.7% to $4.5 million, correspondent and other outside service fees were reduced 11.2% to $11.4 million and other expenses were reduced 14.9% to $9.5 million. **Table 5** provides a summary of changes in non-interest expenses for the past three years.

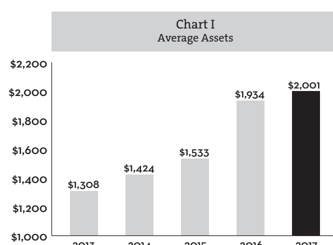
TABLE 5 – NONINTEREST EXPENSE
Year ended December 31,
(dollars in thousands)

	2017	2016	2015	Change 2017/2016	Change 2016/2015
Salaries and incentives	$ 67,576	$ 70,739	$ 59,122	-4.47%	19.65%
Employee benefits and taxes	16,490	15,975	12,804	3.22%	24.77%
Net occupancy	6,266	6,437	5,203	-2.66%	23.72%
Furniture and equipment	5,568	6,018	5,018	-7.48%	19.93%
Intangible amortization	5,623	7,005	4,361	-19.73%	60.63%
Marketing, business development, and public relations	3,274	3,239	3,907	1.08%	-17.10%
Supplies, telephone, and postage	4,504	5,538	4,404	-18.67%	25.75%
FDIC insurance	1,311	1,458	1,175	-10.08%	24.09%
Professional fees – legal, audit, and consulting	3,409	3,381	2,552	0.83%	32.48%
Correspondent and other outside service fees	11,422	12,860	9,394	-11.18%	36.90%
Other expenses	9,477	11,142	10,194	-14.94%	9.30%
Total noninterest expense	$134,920	$143,792	$118,134	-6.17%	21.72%

BALANCE SHEET ANALYSIS

OVERVIEW

At December 31, 2017, total assets were $2.14 billion, up $86.5 million from December 31, 2016, primarily as a result of increased loan production. Total average assets of the Company were $2.00 billion in 2017, a $66.8 million, or 3.5%, increase from the $1.93 billion reported in 2016. **Chart I** illustrates average total assets for the past five years. Average earning assets were $1.82 billion in 2017, an increase of $74.2 million, or 4.2 %, from the $1.75 billion reported in 2016. Average earning assets represent 91.2% of average total assets in 2017, compared to 90.5% in 2016. Average interest-bearing liabilities represented 71.6% of average earning assets in 2017, compared to 73.9% in 2016.



INVESTMENT SECURITIES

The Company uses its investment securities portfolio to manage enterprise interest rate risk, provide liquidity, generate interest and dividend income, and as collateral for public funds. While the Company intends to hold its investment securities to maturity, it may sell available-for-sale securities in response to structural changes in interest rate risks and to meet liquidity requirements, among other factors.

At December 31, 2017, investment securities totaled $274.4 million, compared to $278.9 million at December 31, 2016, representing a decrease of $4.5 million. Average investment securities for 2017 were $286.3 million, with a weighted average tax equivalent yield of 2.25%, compared with $280.0 million and a weighted average tax equivalent yield of 2.31% for 2016. The investment securities portfolio has been managed to meet the Company's investment portfolio guidelines for yield and duration.

The Company's available-for-sale securities are carried at fair value with changes in fair value reflected in other comprehensive income (loss) unless a security is deemed to be other-than-temporarily impaired. At December 31, 2017, the Company's gross unrealized gains on the available-for-sale securities were $1.1 million, compared with $1.3 million at December 31, 2016. Gross unrealizable losses on available-for-sale securities totaled $2.6 million at December 31, 2017, compared with $4.4 million at December 31, 2016.

The Company conducts a regular assessment of its investment portfolio to determine whether any securities are other-than-temporarily impaired. When assessing unrealized losses for other-than-temporary impairment, the Company considers the nature of the investment, the financial condition of the issuer, the extent and duration of the unrealized loss, and expected cash flows of the underlying assets and market conditions. On December 31, 2017, the Company held certain investments having continuous unrealized loss positions for more than 12 months. As of December 31, 2017, the unrealized losses on these securities totaled $1.54 million. During the year ended December 31, 2017, the Company evaluated all of its debt securities for credit impairment and determined there were no credit losses evident. At December 31, 2017, the Company had no plans to sell securities with unrealized losses and believes it is unlikely that it would be required to sell such securities before a recovery of their amortized cost.

LOANS

Total loans were $1.57 billion at December 31, 2017, a $207.5 million increase from December 31, 2016. The increase was primarily the result of growth in the commercial loan portfolios and the retention of single family mortgage loans originated through the Company's mortgage division. **Table 6** sets forth the composition of the loan portfolio, both in terms of dollars and percentage for the past five years. Average loans were $1.48 billion in 2017, a $129.8 million, or 9.7%, increase from the $1.35 billion reported in 2016. The average loan to deposit ratio increased to 82.2% for 2017, from 77.4% for 2016.

The Company periodically sells loans to a participation network to manage concentration risk and reduce credit exposure. The sold loan portfolio was $591.8 million on December 31, 2017, a $33.6 million, or 5.4%, decrease from the $625.4 million reported at December 31, 2016. The Company also had $17.9 million of mortgages held for sale at December 31, 2017, a $17.1 million, or 48.9%, decrease from the $35.1 million reported at December 31, 2016. Mortgages held for sale are all single-family residential mortgage loans that will be sold to the secondary market, usually within 30 days of origination.

TABLE 6 – LOANS
As of December 31,
(dollars in thousands)

	2017	2016	2015	2014	2013
Commercial					
Commercial and industrial	$ 436,980	$ 435,798	$ 379,914	$ 351,460	$328,183
Real estate construction	22,348	34,654	16,780	20,544	8,260
Real estate mortgage	444,857	380,045	261,345	256,281	259,681
Farmland and agricultural	43,615	48,659	53,514	62,340	54,245
Total commercial	947,800	899,156	711,553	690,625	650,369
Consumer					
Real estate 1-4 family first mortgage	348,964	202,217	170,397	167,177	108,682
Real estate 1-4 family junior mortgage	195,103	178,795	162,295	157,921	95,348
Automobile	56,928	58,332	62,509	57,214	46,150
Other revolving and installment	25,679	28,452	20,167	22,521	14,015
Total consumer	626,674	467,796	415,368	404,833	264,195
Total loans	$1,574,474	$1,366,952	$1,126,921	$1,095,458	$914,564
Percent Of Loans By Type					
Commercial					
Commercial and industrial	27.8%	31.9%	33.7%	32.1%	35.9%
Real estate construction	1.4%	2.5%	1.5%	1.9%	0.9%
Real estate mortgage	28.3%	27.8%	23.2%	23.4%	28.4%
Farmland and agricultural	2.8%	3.6%	4.7%	5.7%	5.9%
Total commercial	60.2%	65.8%	63.1%	63.0%	71.1%
Consumer					
Real estate 1-4 family first mortgage	22.2%	14.8%	15.1%	15.3%	11.9%
Real estate 1-4 family junior mortgage	12.4%	13.1%	14.4%	14.4%	10.4%
Automobile	3.6%	4.3%	5.5%	5.2%	5.0%
Other revolving and installment	1.6%	2.1%	1.8%	2.1%	1.5%
Total consumer	39.8%	34.2%	36.9%	37.0%	28.9%
Total loans and leases	100.0%	100.0%	100.0%	100.0%	100.0%

DEPOSITS

Deposits totaled $1.83 billion at December 31, 2017, compared with $1.79 billion at December 31, 2016, representing an increase of $49.8 million, or 2.8%. Core deposits provide the Company's major source of funds from individuals, businesses, and local government units Core deposits include noninterest-bearing deposits, interest-bearing checking, certificates of deposit less than $250 thousand, and money market saving deposits. Core deposits funded 84.5% and 85.6% of total assets at December 31, 2017, and 2016, respectively. Average deposits were $1.80 billion in 2017, a $58.3 million, or 3.4%, increase, compared with the $1.74 billion reported in 2016. During the fourth quarter of 2017, the Company converted $92.5 million of Health Savings Account (HSA) deposits, which were acquired in the ABGNCS acquisition, to the Bank. The HSA deposits were previously held in a custody relationship at another bank, as ABGNCS was not a depository institution.

Noninterest-bearing deposits were $619.3 million at December 31, 2017, a $64.8 million, or 11.7%, increase from the $554.5 million reported at December 31, 2016. Average noninterest-bearing deposits were $488.3 million in 2017, a $44.8 million, or 10.1%, increase compared with $443.5 million in 2016.

Interest-bearing non-maturity deposits totaled $1.01 billion at December 31, 2017, a $21.2 million, or 2.1%, increase from the $990.2 million reported at December 31, 2016. Average interest-bearing non-maturity deposits were $956.6 million in 2017, a $15.4 million, or 1.6%, decrease compared with $972.0 million in 2016. Interest-bearing time deposits were $204.3 million at December 31, 2017, a $36.3 million, or 15.1%, decrease from the $240.5 million reported at December 31, 2016. Average interest-bearing time deposits were $219.2 million in 2017, a $32.2 million, or 12.8%, decrease compared with $251.4 million reported in 2016. Time certificates of deposit are managed to levels deemed appropriate given alternative funding sources. **Table 7** provides a summary of changes in deposits for the past five years.

TABLE 7 – DEPOSITS
As of December 31,
(dollars in thousands)

	2016	2015	2014	2013	2012
Non-interest-bearing deposits	$ 619,333	$ 554,490	$ 425,608	$ 330,218	$ 305,042
Interest-bearing deposits					
Savings accounts	50,794	48,371	37,798	30,397	24,750
Interest-bearing checking accounts	416,991	325,474	291,979	243,334	186,916
Money market savings	543,583	616,341	486,181	447,346	439,946
Certificates of deposit of $250,000 and less	176,010	210,312	191,568	182,099	190,767
Certificates of deposit in excess of $250,000	28,251	30,221	24,887	28,774	35,182
Total interest-bearing deposits	1,215,629	1,230,719	1,032,413	931,950	877,561
Total deposits	$1,834,962	$1,785,209	$1,458,021	$1,262,168	$1,182,603
Percent Of Deposits By Type					
Non-interest-bearing deposits	33.8%	31.1%	29.2%	26.2%	25.8%
Interest-bearing deposits					
Savings accounts	2.8%	2.7%	2.6%	2.4%	2.1%
Interest-bearing checking accounts	22.7%	18.2%	20.0%	19.3%	15.8%
Money market savings	29.6%	34.5%	33.3%	35.4%	37.2%
Certificates of deposit of $250,000 and less	9.6%	11.8%	13.1%	14.4%	16.1%
Certificates of deposit in excess of $250,000	1.5%	1.7%	1.7%	2.3%	3.0%
Total interest-bearing deposits	66.2%	68.9%	70.8%	73.8%	74.2%
Total deposits	100.0%	100.0%	100.0%	100.0%	100.0%

BORROWINGS

The Company utilizes both short-term and long-term borrowings as part of its asset/liability management and funding strategies. Short-term borrowings, as of December 31, 2017, totaled $30.0 million, compared to $0.7 million reported at December 31, 2016. Short-term borrowings consists of Federal Home Loan Bank advances and Federal Funds Purchased.

The Company utilizes long-term debt to fund longer term assets and as a source of regulatory capital. Long-term debt was $58.8 million as of December 31, 2017 and 2016. Long-term debt at December 31, 2017 and 2016, included subordinated notes, trust preferred securities, and a capital lease obligation on the Corporate Center office located in Grand Forks, North Dakota.

On December 17, 2015, the Company issued $50 million of subordinated notes with a maturity date of December 30, 2025. The notes bear a fixed rate of interest at 5.75%, through December 30, 2020, and then convert to floating-rate notes that reset quarterly to an interest rate equal to three month LIBOR plus 412 basis points. Through December 30, 2020, interest is payable semi-annually on June 30 and December 30, and thereafter interest is paid quarterly on March 30, June 30, September 30, and December 30. The subordinated notes qualify as Tier 2 capital for regulatory purposes. The proceeds were utilized for the acquisitions of ABGNCS and Beacon Bank in January 2016 and to retire the $20.0 million of SBLF preferred stock in February 2016.

In January 2016, the Company acquired Beacon Bank and assumed $10.0 million of trust preferred securities, junior subordinated debentures, in two trusts. Trust I was formed in 2003 and issued $4.0 million of floating rate notes that bear interest at three-month LIBOR plus 3.10%, and reset quarterly. Trust II was formed in 2006 and issued $6.0 million of floating rate notes that bear interest at three-month LIBOR plus 1.80%, and reset quarterly. The Trust I securities mature on June 26, 2033, and Trust II securities mature on September 15, 2036. Both are redeemable with the approval of the Federal Reserve Board, in whole or in part, at the Company's option at any time upon the occurrence of certain events affecting their tax or regulatory capital treatment. The trust preferred securities were marked to market at the time of the Beacon Bank acquisition and are reported on the balance sheet at $8.3 million, as of December 31, 2017, and $8.2 million as of December 31, 2016.

CAPITAL RESOURCES

The Company is committed to managing capital for maximum stockholder benefit and maintaining strong protection for depositors and creditors. The Company continually assesses its business risk and capital position. The Company also manages its capital to exceed regulatory capital requirements for well-capitalized bank holding companies. Total common stockholders' equity was $180.6 million at December 31, 2017, an $11.8 million, or 7.0%, increase from the $168.8 million reported at December 31, 2016. The increase is the result of current year's earnings less dividend payments to common stockholders, and the market value change, net of the related tax impact, in the investment portfolio.

In 2012 the Company applied for and received approval for $20 million in SBLF at an initial interest rate of 1.0%. The Company viewed the SBLF as an intermediate source of capital and redeemed the preferred stock in February 2016 utilizing a portion of the proceeds from the subordinated note issuance. The SBLF preferred stock interest rate was scheduled to increase to 9% in February 2016.

The Company paid dividends of $0.48 during 2017, representing a $0.04, or 9.1%, increase over the $0.44 paid during 2016. Dividends per share data was adjusted for a 3-for-1 stock split completed in the third quarter of 2014. The Company's dividend policy is influenced by the belief that most stockholders are interested in

long-term appreciation as well as current yield. The current dividend yield is considered reasonable given the Company's present cash flow position, level of earnings, and the strength of its capital.

Banking industry regulators define minimum capital and well capitalized standards for banks and holding companies (see The Company and Bank Required Capital Levels section of this report). The Company's and the Bank's regulatory capital ratios, as of December 31, for the past five years are set forth in **Table 8** and exceeded all minimum capital and well capitalized standards. The acquisitions that closed in January 2016 utilized a substantial amount of the Company's excess capital, and significantly increased the asset base of the Company, which reduced regulatory capital ratios.

The Basel III regulatory capital reforms (the "Basel III Rule"), effective beginning January 1, 2015, contain provisions which require certain adjustments and deductions from common equity Tier 1 capital, including goodwill and other intangible assets (excluding mortgage servicing rights). The Basel III Rule provided for a phase-in period for certain deductions from capital that requires deductions of 40% in 2015, 60% in 2016, 80% in 2017, and 100% thereafter of the deduction. The Company's deduction for goodwill and identifiable intangible assets, net of deferred tax liabilities, represents goodwill of $26.3 million and identifiable intangible assets of $21.8 million (80% of $27.2 million) as of December 31, 2017, and goodwill of $27.7 million and identifiable intangible assets of $19.6 million (60% of $32.7 million) as of December 31, 2016.

TABLE 8 – REGULATORY CAPITAL
As of December 31,

	Well Capitalized	2017	2016	2015	2014	2013
Alerus Financial Corporation						
Common equity tier 1	N/A	7.8%	7.7%	10.9%	N/A	N/A
Tier 1 capital	8.0%	8.3%	8.2%	12.3%	11.8%	12.8%
Total capital	10.0%	12.2%	12.3%	17.0%	13.0%	14.1%
Tier 1 leverage	N/A	7.1%	6.9%	10.9%	10.1%	10.6%
Alerus Financial, NA						
Common equity tier 1	6.5%	11.0%	11.1%	14.4%	N/A	N/A
Tier 1 capital	8.0%	11.0%	11.1%	14.4%	11.3%	12.3%
Total capital	10.0%	12.0%	12.1%	15.4%	12.5%	13.5%
Tier 1 leverage	5.0%	9.4%	9.3%	12.6%	9.6%	10.1%

RISK ANALYSIS

ASSET QUALITY RISK

Management believes its ability to identify and assess the risk and return characteristics of the Company's loan portfolio is critical for profitability and growth. It is in the best interest of stockholders, regional communities, clients, and the Company to follow a credit policy that carefully balances risk and return, and ensures that potential credit problems are closely monitored.

The Company's strategy for credit risk management includes well-defined, centralized credit policies; uniform underwriting criteria; and ongoing risk monitoring and review processes for all commercial and consumer credit exposures. The strategy also emphasizes diversification on a geographic, industry, and client level; regular credit examinations; and management reviews of loans experiencing deterioration of credit quality. The Company strives to identify potential problem loans early, take necessary charge-offs promptly, and maintain adequate reserve levels for probable loan losses inherent in the portfolio. Management performs ongoing, internal reviews of any problem credits and continually assesses the adequacy of the allowance. The Company utilizes an internal lending division, Special Credit Services, to develop and implement strategies for the management of individual nonperforming loans.

The allowance provides coverage for probable and estimable losses inherent in the Company's loan portfolios. Management evaluates the allowance each quarter to determine if it is adequate to cover inherent losses. The evaluation of each element and the overall allowance is based on a continuing assessment of problem loans and related off-balance sheet items, historic loss experience, and other factors including regulatory guidance and economic conditions.

At December 31, 2017, nonperforming assets were $6.4 million, compared to $9.6 million in 2016, and $12.0 million in 2015. Nonperforming assets represented 0.40% of total loans and other real estate in 2017, compared to 0.70% in 2016, and 1.07% in 2015. **Table 9** provides a summary of nonperforming assets for the past five years.

At December 31, 2017, the allowance for loan losses was $16.6 million, or 1.05%, of total loans compared with $15.6 million, or 1.14%, at December 31, 2016, and $14.7 million, or 1.30%, at December 31, 2015. The provision for loan losses was $3.3 million in 2017, as compared to $3.1 million in 2016 and $4.2 million in 2015. Net charge-offs in 2017 were $2.3 million, or 0.16%, of average total loans, compared to $2.1 million, or 0.16%, in 2016, and $6.6 million, or 0.58%, in 2015. The Company considers its allowance of $16.6 million adequate to cover losses inherent in loans, commitments to extend credit, and standby letters of credit at December 31, 2017. **Table 10** provides a summary of the credit loss experience for the past five years.

TABLE 9 – NONPERFORMING ASSETS
As of December 31,
(dollars in thousands)

	2017	2016	2015	2014	2013
Commercial					
Commercial and industrial	$ 3,193	$ 2,418	$ 6,011	$ 572	$ 1,437
Real estate construction	61	751	-	-	-
Real estate mortgage	-	149	2,634	1,844	3,091
Farmland and agricultural	-	448	158	-	108
Total commercial	3,254	3,766	8,803	2,416	4,636
Consumer					
Real estate 1-4 family first mortgage	662	1,135	1,501	144	277
Real estate 1-4 family junior mortgage	1,873	2,590	825	1,400	455
Automobile	20	64	-	35	9
Other revolving and installment	64	109	22	-	-
Total consumer	2,619	3,898	2,348	1,579	741
Total nonperforming loans	5,873	7,664	11,151	3,995	5,377
Foreclosed assets	37	196	35	11	11
Other real estate owned	446	1,721	842	2,478	4,877
Total nonperforming assets	$ 6,356	$ 9,581	$ 12,028	$ 6,484	$ 10,265
Nonperforming assets / loans and other real estate	0.40%	0.70%	1.07%	0.59%	1.12%
Allowance for loan losses / nonperforming loans	282.04%	203.74%	131.72%	427.11%	313.15%

TABLE 10 – SUMMARY OF LOAN LOSS EXPERIENCE
As of December 31,
(dollars in thousands)

	2017	2016	2015	2013	2013
Average loans	$1,475,042	$1,345,209	$1,124,601	$ 994,047	$832,445
Balance – beginning of period	$ 15,615	$ 14,688	$ 17,063	$ 16,838	$ 15,101
Provision for loan losses	3,280	3,060	4,200	(400)	1,200
Commercial loan charge-offs					
Commercial and Industrial	2,748	1,405	6,797	408	538
Real estate construction	-	1,655	-	4	2
Real estate mortgage	-	43	400	79	16
Farmland and Agriculture	539	224	109	73	-
Total commercial loan charge-offs	3,287	3,327	7,306	564	556
Consumer loan charge-offs					
Real estate 1-4 family first mortgage	-	-	5	1	10
Real estate 1-4 family junior mortgage	1,124	829	596	267	146
Automobile	313	97	155	128	148
Other revolving and installment	116	183	115	60	225
Total consumer loan charge-offs	1,553	1,109	871	456	529
Total loan charge-offs	**4,840**	**4,436**	**8,177**	**1,020**	**1,085**
Commercial loan recoveries					
Commercial and Industrial	736	1,055	230	968	1,187
Real estate construction	279	587	697	128	200
Real estate mortgage	73	188	166	201	75
Farmland and Agriculture	194	29	3	20	19
Total commercial recoveries	1,282	1,859	1,096	1,317	1,481
Consumer loan recoveries					
Real estate 1-4 family first mortgage	103	211	10	70	6
Real estate 1-4 family junior mortgage	872	94	287	113	36
Automobile	150	54	93	55	15
Other revolving and installment	102	85	116	90	84
Total consumer loan recoveries	1,227	444	506	328	141
Total loan recoveries	2,509	2,303	1,602	1,645	1,622
Net loan (charge-offs) recoveries	(2,331)	(2,133)	(6,575)	625	537
Balance – end of period	$ 16,564	$ 15,615	$ 14,688	$ 17,063	$ 16,838

LIQUIDITY RISK

The Company's liquidity risk management process is designed to identify, measure, and manage the Company's funding and liquidity risk to meet its daily funding needs and to address expected and unexpected changes in its funding requirements. The Asset/Liability Committee ("ALCO") establishes policies, as well as analyzes and manages the Company's liquidity to ensure adequate funds are always available at reasonable rates to meet normal operating requirements in addition to unexpected client demands for funds, such as high levels of deposit withdrawals or loan demand, in a timely and cost effective manner. Liquidity needs are provided for on both the asset and liability side of the balance sheet. Asset liquidity is provided by regular maturities of loans and maintaining relatively short-term, marketable investments and federal funds. As of December 31, 2017, the Company had $75.2 million of un-pledged, available-for-sale securities. Liability liquidity is provided through short-term federal fund borrowings and borrowing capacity at the Federal Home Loan Bank. As of December 31, 2017, the Company had $87.0 million of unsecured lines of credit for federal funds that may be drawn as needed and borrowing capacity at the Federal Home Loan Bank of $367.6 million.

INTEREST RATE RISK

The Company's major market risk exposure is to changes in interest rates. To minimize the volatility of net interest income and exposure to economic loss, the Company manages its exposure to interest rate risk through asset/liability management activities within the guidelines established by ALCO and approved by the Board of Directors.

Interest rate risk can be broken down into the following four components: 1) repricing risk results from the difference in the timing of rate changes and the timing of cash flows that occur in the pricing and maturity of the bank's assets and liabilities, 2) basis risk occurs when market rates for different financial instruments, or the indices used to price assets and liabilities change at different times or by different amounts, 3) option risk occurs when clients have the right to alter the level and/or timing of the cash flows of an asset or a liability, and 4) term structure risk occurs from variations in the movement of interest rates across maturity spectrums. Interest rate risk is managed within an overall asset/liability framework for the Company. The Company positions the balance sheet to be interest rate neutral to slightly asset sensitive, defined as allowing assets on the balance sheet to reprice faster than the liabilities. The Company chooses to manage the balance sheet to be slightly asset sensitive to take advantage of a normally upward sloping yield curve.

The Company utilizes the services of an external consulting firm to facilitate the sensitivity analysis in the form of net interest income simulation to help quantify the existing interest rate risk embedded in the Company's balance sheet and to help identify ways to minimize the risk. The quarterly analysis incorporates substantially all of the Company's assets and liabilities and off-balance sheet instruments, together with forecasted changes in the balance sheet and assumptions that reflect the current interest rate environment. The simulation model is used to measure the impact on net interest income, relative to a base case scenario, of interest rates increasing or decreasing 100, 200, and 300 basis points over the next 12 months. The simulation run at December 31, 2017, illustrates a negative 2.57% change in net interest income for a 100 basis point decline in interest rates, and a positive 2.03% change in net interest income for a 200 basis point rise in interest rates. The Company has established policy limits and was within the limits as of December 31, 2017. The base case interest rates for the simulation included the prime rate at 4.50% and the federal funds rate at 1.50%.

The Company has successfully implemented interest rate floors in a substantial number of underlying loan contracts at rates above market indications. These interest rate floors have preserved net interest rate margin in the current environment but will cause slight interest rate compression as interest rates rise since these loans will not reprice until the floor rate is surpassed.

LINE OF BUSINESS FINANCIAL REVIEW

The Company's major lines of business are Banking, Mortgage, Retirement and Benefits, and Wealth Management. These business lines are components of the Company for which financial information is prepared and evaluated regularly by management in deciding how to allocate resources and assess performance. Business line reporting was instituted in 2016, and therefore only two years of historical information is available.

The business line results are derived from the Company's business unit profitability reporting systems and are non-GAAP financial measures. The Selected Financial Information presented on each business line sets forth revenue and direct noninterest expense before indirect overhead allocations. Corporate Administration includes the indirect overhead and is set forth in the table below along with income tax expense and the Consolidated Company net income. The business line net income before taxes represents direct revenue and expense before indirect allocations and income taxes. Certain reclassification adjustments have been made between Corporate Administration and the various lines of business for consistency in presentation. **Table 11** sets forth the business line performance for 2017 and 2018.

TABLE 11 – BUSINESS LINE PERFORMANCE
As of December 31,
(dollars in thousands)

	2017	2016	Change %
Banking	$ 38,281	$ 34,511	10.9%
Mortgage	3,040	5,555	-45.3%
Retirement and Benefits	20,413	13,325	53.2%
Wealth Management	6,541	5,102	28.2%
Corporate Administration	(35,346)	(37,324)	-5.3%
Income before income taxes	32,929	21,169	55.6%
Income tax expense	17,485	7,138	145.0%
Net income	$ 15,444	$ 14,031	10.1%

Net income for the Company increased 10.1% in 2017, with strong growth in net income before taxes in Banking, 10.9%, Retirement and Benefits, 53.2%, and Wealth Management, 28.2%. Mortgage net income before taxes decreased 45.3% due to lower origination volumes and retention of more loans for the Banking portfolio. Pretax income increased 55.6% to $32.9 million from the $21.2 million reported for 2017. Income tax expense increased 145.0% to $17.5 million, primarily as a result of the deferred tax charges incurred during 2017, as previously reported.

Assets Under Administration (AUA) & Assets Under Management (AUM)

Table 12 sets forth the business lines where assets are administered and assets are managed. AUA include assets that are administered in both Retirement and Benefits and Wealth Management. AUM for Retirement and Benefits includes assets that are also administered and are included in the AUA number for Retirement and Benefits. Internally managed assets include the bank's investment portfolio and certain funds that are internally managed by the Wealth Management business line.

TABLE 12 – ASSETS UNDER ADMINISTRATION & ASSETS UNDER MANAGEMENT
As of December 31,
(dollars in thousands)

	2017	2016	Change %
Assets Under Administration (AUA)			
Retirement & Benefits	$ 28,127,961	$ 24,950,545	12.7%
Wealth Management	92,285	77,545	19.0%
Total Assets Under Administration	$ 28,220,246	$ 25,028,090	12.8%
Assets Under Management (AUM)			
Retirement & Benefits	$ 1,238,404	$ 1,158,340	6.9%
Wealth Management	2,609,681	2,221,447	17.5%
Total Assets Under Management	$ 3,848,085	$ 3,379,787	13.9%
Internally Managed Assets	$ 529,778	$ 514,021	3.1%

AUA increased 12.8% during 2017 from $25.0 billion to $28.2 billion, driven by organic growth and increases in the market values of AUA. AUM increased 13.9% from $3.4 billion to $3.8 billion due to solid organic growth and market value increases.

Banking offers a complete line of loan, deposit, cash management, and treasury services through seventeen offices in North Dakota, Minnesota, and Arizona. These products and services are supported through web and mobile based applications. The majority of the Company's assets and liabilities are on the Banking business line balance sheet. **Table 13** sets forth the banking business line performance for 2017 and 2016.

TABLE 13 – BANKING BUSINESS LINE PERFORMANCE
As of December 31,
(dollars in thousands)

	2017	2016	Change %
Condensed Income Statement			
Net interest income	$ 70,377	$ 64,990	8.3%
Noninterest income	7,180	6,895	4.1%
Total net revenue	77,557	71,885	7.9%
Provision for loan losses	3,280	3,060	7.2%
Noninterest expense	35,996	34,314	4.9%
Net income before income taxes	$ 38,281	$ 34,511	10.9%
Average Balance Sheet			
Total loan	$ 1,474,774	$ 1,343,208	9.8%
Goodwill	20,130	18,464	.0%
Other intangible assets	3,200	3,881	-17.5%
Total Assets	1,936,945	1,845,947	4.9%
Deposits	1,664,022	1,666,792	-0.2%

Banking reported net income before income taxes of $38.3 million on revenue of $77.6 million for 2017, compared with net income before taxes of $34.5 million on revenues of $71.9 million for 2016. Net interest income increased 8.3% as a result of a 9.8% increase in the average loans outstanding. Noninterest income, provision for loan losses, and noninterest expense were comparable for the full years of 2017 and 2016. Average loans increased by $131.6 million and average deposits were flat for the year.

Mortgage offers first and second mortgage loans through a centralized mortgage unit in Minneapolis, Minnesota as well as through the Banking office locations.

TABLE 14 – MORTGAGE BUSINESS LINE PERFORMANCE
As of December 31,
(dollars in thousands)

	2017	2016	Change %
Condensed Income Statement			
Net interest income	$ 740	$ 1,302	-43.2%
Noninterest income	21,402	26,949	-20.6%
Total net revenue	22,142	28,251	-21.6%
Noninterest expense	19,102	22,696	-15.8%
Net income before income taxes	$ 3,040	$ 5,555	-45.3%
Mortgage originations	$ 867,253	$1,065,132	-18.6%

Mortgage reported net income before taxes of $3.0 million on revenue of $22.1 million for 2017 compared to net income before taxes of $5.6 million on revenue of $28.3 million for 2016. Mortgage originations for 2017 were $867.3 million as compared to $1.1 billion in 2016. Net interest income is generated from the Loans Held for Sale portfolio, while noninterest income is primarily from the gain on sale of mortgage loans. During 2017, the Company retained a higher volume of loans on balance sheet, $176.5 million, compared to the $48.7 million retained in 2016. This resulted in lower noninterest income for Mortgage, but higher net interest income for the Banking business line. Noninterest expense decreased from $22.7 million to $19.1 million, or 15.8%, during the year on lower commission expense due to lower volumes, and the deferral of loan origination expenses associated with portfolio loans. Mortgage business line performance for 2017 and 2016 is set forth in **Table 14**.

Retirement and Benefits offers retirement plan administration and investment advisory services, ESOP fiduciary services, payroll, health savings account, and other benefit services to clients nationwide. The Retirement and Benefits segment has over $28.1 billion of Assets Under Administration (AUA) in all 50 states. **Table 15** sets forth the retirement and benefits business line performance for 2017 and 2016.

TABLE 15 - RETIREMENT AND BENEFITS BUSINESS LINE PERFORMANCE
As of December 31,
(dollars in thousands)

	2017	2016	Change %
Condensed Income Statement			
Noninterest income	$ 62,390	$ 57,804	7.9%
Total net revenue	62,390	57,804	7.9%
Noninterest expense	41,977	44,479	-5.6%
Net income before income taxes	$ 20,413	$ 13,325	53.2%
Assets under management	$ 1,238,404	$ 1,158,340	6.9%
Assets under administration	28,127,961	24,950,545	12.7%

Retirement and Benefits reported net income before taxes of $20.4 million on revenue of $62.4 million for 2017 compared to $13.3 million net income before taxes on revenue of $57.8 million for 2016. Noninterest expense for 2017 was $42.0 million as compared to $44.5 million for 2016, a decrease of 5.6% as a result of acquisition related expenses in 2016. AUA increased to $28.1 billion from $25.0 billion during the year, primarily due to increasing market values.

Wealth Management offers trust and fiduciary services, investment management, and financial planning services to clients, and has $3.1 billion of Assets Under Management (AUM), $2.6 billion for external clients, and $530 million for internal clients, including the Banking investment portfolio. **Table 16** sets forth the wealth management business line performance for 2017 and 2016.

Wealth Management reported net income before taxes of $6.5 million on revenue of $14.7 million for 2017 as compared to net income before taxes of $5.1 million on revenue of $13.7 million for 2016. Total net revenue increased 7.6%, while noninterest expense decreased 4.7%. Noninterest expense decreased from $8.6 million to $8.2 million during the year. AUM increased 14.8% from $2.74 billion to $3.14 billion during the year.

TABLE 16 – WEALTH MANAGEMENT BUSINESS LINE PERFORMANCE
As of December 31,
(dollars in thousands)

	2017	2016	Change %
Condensed Income Statement			
Net interest income	$ 57	$ 54	5.6%
Noninterest income	14,660	13,629	7.6%
Total net revenue	14,717	13,683	7.6%
Noninterest expense	8,176	8,581	-4.7%
Net income before income taxes	$ 6,541	$ 5,102	28.2%
Assets under management	$ 2,609,681	$ 2,221,447	17.5%
Assets under administration	92,285	77,545	19.0%
Internally managed assets	529,778	514,021	3.1%

REGULATORY CHANGES

Financial institutions, their holding companies and their affiliates, along with securities broker dealers, registered investment advisors, and insurance agencies, are extensively regulated under federal and state law. As a result, the growth and earnings performance of the Company may be affected not only by management decisions and general economic conditions, but also by requirements of federal and state statutes and by the regulations and policies of various bank regulatory agencies, including the Office of the Comptroller of the Currency (the "OCC"), the Board of Governors of the Federal Reserve System (the "Federal Reserve"), the Federal Deposit Insurance Corporation (the "FDIC"), and the Bureau of Consumer Financial Protection (the "CFPB"). Furthermore, taxation laws administered by the Internal Revenue Service and state taxing authorities, accounting rules developed by the Financial Accounting Standards Board (the "FASB"), and securities laws administered by the Securities and Exchange Commission (the "SEC") and state securities authorities have an impact on the business of the Company. The effect of these statutes, regulations, regulatory policies, and accounting rules are significant to the operations and results of the Company, the Bank, and its indirect subsidiary, Alerus Securities Corporation.

Federal and state banking laws impose a comprehensive system of supervision, regulation, and enforcement on the operations of financial institutions, their holding companies, and affiliates that is intended primarily for the protection of the FDIC-insured deposits and depositors of banks, rather than stockholders. These federal and state laws, and the regulations of the bank regulatory agencies issued under them, affect, among other things, the scope of business, the kinds and amounts of investments banks may make, reserve requirements, capital levels relative to operations, the nature and amount of collateral for loans, the establishment of branches, the ability to merge, consolidate and acquire, dealings with insiders and affiliates, and the payment of dividends. Federal and state securities and insurance laws impose a comprehensive system of supervision, regulation, and enforcement on the operations of securities broker dealers, registered investment advisors, and insurance agencies' financial institutions, that is intended primarily for the protection of clients, rather than stockholders.

The following is a summary of the material elements of the supervisory and regulatory framework applicable to the Company and the bank. It does not describe all of the statutes, regulations, and regulatory policies that apply, nor does it restate all of the requirements of those that are described. The descriptions are qualified in their entirety by reference to the particular statutory and regulatory provision.

FINANCIAL REGULATORY REFORM

On July 21, 2010, former President Barack Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") into law. The Dodd-Frank Act represented a sweeping reform of the U.S. supervisory and regulatory framework applicable to financial institutions and capital markets in the wake of the global financial crisis. In particular, and among other things, the Dodd-Frank Act: (i) created a Financial Stability Oversight Council as part of a regulatory structure for identifying emerging systemic risks and improving interagency cooperation; (ii) created the CFPB, which is authorized to regulate providers of consumer credit, savings, payment, and other consumer financial products and services; (iii) narrowed the scope of federal preemption of state consumer laws enjoyed by national banks and federal savings associations and expanded the authority of state attorneys general to bring actions to enforce federal consumer protection legislation; (iv) imposed more stringent capital requirements on bank holding companies and subjected certain activities, including interstate mergers and acquisitions, to heightened capital conditions; (v) with respect to mortgage lending, (a) significantly expanded requirements applicable to loans secured by 1-4 family residential real property, (b) imposed strict rules on mortgage servicing, and (c) required the originator of a securitized loan, or the sponsor of a securitization, to retain at least 5% of the credit risk of securitized exposures unless the underlying exposures are qualified residential mortgages or meet certain underwriting standards; (vi) repealed the prohibition on the payment of interest on business checking accounts; (vii) restricted the interchange fees payable on debit card transactions for issuers with $10 billion in assets or greater; (viii) in the so-called "Volcker Rule," subject to numerous exceptions, prohibited depository institutions and affiliates from certain investments in, and sponsorship of, hedge funds and private equity funds and from engaging in proprietary trading; (ix) provided for enhanced regulation of advisers to private funds and of the derivatives markets; (x) enhanced oversight of credit rating agencies; and (xi) prohibited banking agency requirements tied to credit ratings. These statutory changes shifted the regulatory framework for financial institutions and impacted the way in which they do business.

THE INCREASING REGULATORY EMPHASIS ON CAPITAL

Regulatory capital represents the net assets of a financial institution available to absorb losses. Because of the risks attendant to their businesses, depository institutions are generally required to hold more capital than other businesses, which directly affects returns on equity. Certain provisions of the Dodd-Frank Act and the Basel III Rule establish strengthened capital standards for banks and bank holding companies, require more capital to be held in the form of common stock, and disallow certain funds from being included in capital determinations. Once fully implemented, these standards will represent regulatory capital requirements that are meaningfully more stringent than those in place historically.

THE COMPANY AND BANK REQUIRED CAPITAL LEVELS

The Company and the Bank are subject to various regulatory capital adequacy requirements administered by the Federal Reserve and the OCC. Bank holding companies have historically had to comply with less stringent capital standards than their bank subsidiaries and were able to raise capital with hybrid instruments such as trust preferred securities and subordinated debentures. The Dodd-Frank Act mandated the Federal Reserve to establish minimum capital levels for bank holding companies on a consolidated basis that are as stringent as those required for insured depository institutions. Additionally, after an extended rulemaking process, the U.S. federal banking agencies approved the implementation of the Basel III Rule, and, at the same time, promulgated rules effecting certain changes required by the Dodd-Frank Act, effective beginning January 1, 2015.

The Basel III Rule not only increased most of the required minimum capital ratios, but it also introduced the concept of Common Equity Tier 1 Capital (CET1), which consists primarily of common stock, related surplus (net of treasury stock), retained earnings, and CET1 minority interests subject to certain regulatory adjustments. The Basel III Rule also expanded the definition of capital by establishing more stringent criteria that instruments must meet to be considered Additional Tier 1 Capital (Tier 1 Capital in addition to Common Equity) and Tier 2 Capital. A number of instruments that previously qualified as Tier 1 Capital do not qualify, or their qualifications changed. For example, cumulative preferred stock and certain hybrid capital instruments, including trust preferred securities, no longer qualify as Tier 1 Capital of any kind, with the exception, subject to certain restrictions, of such instruments issued before May 10, 2010, by bank holding companies with total consolidated assets of less than $15 billion as of December 31, 2009. For those institutions, trust preferred securities and other non-qualifying capital instruments previously included in consolidated Tier 1 Capital are permanently grandfathered under the Basel III Rule, subject to certain restrictions. Qualifying trust preferred securities may also be assumed in conjunction with a bank acquisition without impairing their grandfathered Tier 1 capital status. Noncumulative perpetual preferred stock, which qualified as simple Tier 1 Capital, does not qualify as CET1, but does qualify as Additional Tier 1 Capital. The Basel III Rule also constrains the inclusion of minority interests, mortgage-servicing assets, and deferred tax assets in capital and requires deductions from CET1 in the event such assets exceed a certain percentage of a bank's CET1.

The Basel III Rule contains provisions which require certain adjustments and deductions from common equity Tier 1 capital, including goodwill and other intangible assets (excluding mortgage servicing rights). The Basel III Rule provided for a phase-in period for certain deductions from capital that requires deductions of 40% in 2015, 60% in 2016, 80% in 2017, and 10% thereafter of the deduction. Identifiable intangible assets that are not deducted during the transitional period are risk weighted.

Under current federal regulations, incorporating the Basel III Rule, the Bank is subject to the following minimum capital standards:

- 4.5% CET1 to risk-weighted assets;
- 6.0% Tier 1 capital (i.e., CET1 plus Additional Tier 1) to risk-weighted assets;
- 8.0% Total capital (i.e., Tier 1 plus Tier 2) to risk-weighted assets; and
- 4.0% Tier 1 capital to average consolidated assets as reported on consolidated financial statements (leverage ratio).

In addition, institutions that seek the freedom to make capital distributions (including for dividends and repurchases of stock) and pay discretionary bonuses to executive officers without restriction must also maintain 2.5% of risk-weighted assets in Common Equity Tier 1 attributable to a capital conservation buffer to be phased-in over three years, beginning in 2016. The purpose of the conservation buffer is to ensure that banks maintain a buffer of capital that can be used to absorb losses during periods of financial and economic stress. Factoring in the fully phased-in conservation buffer increases the minimum ratios depicted above to 7.0% for CET1, 8.5% for Tier 1 Capital, and 10.5% for Total Capital. The leverage ratio is not impacted by the conservation buffer.

The Basel III Rule maintained the general structure of the current prompt corrective action framework, while incorporating the increased requirements. The prompt corrective action guidelines were also revised to add the CET1 Capital ratio. In order to be a "well-capitalized" depository institution under the new regime, a bank and holding company must maintain a CET1 Capital ratio of 6.5% or more, a Tier 1 Capital ratio of 8% or more, a Total Capital ratio of 10% or more, and a leverage ratio of 5% or more. It is possible under the Basel III Rule to be well-capitalized while remaining out of compliance with the capital conservation buffer discussed above.

The Basel III Rule revised a number of the risk weightings (or their methodologies) for bank assets that are used to determine the capital ratios. For nearly every class of assets, the Basel III Rule required a more complex, detailed, and calibrated assessment of credit risk and calculation of risk weightings.

Furthermore, there was significant concern noted by the financial industry in connection with the Basel III Rule as to the proposed treatment of accumulated other comprehensive income ("AOCI"). The Basel III Rule requires unrealized gains and losses on available-for-sale securities to flow through to regulatory capital as opposed to the previous treatment, which neutralizes such effects. Recognizing the problem for community banks, the U.S. bank regulatory agencies adopted the Basel III Rule with a one-time election for smaller institutions like the Company and the Bank to opt out of, including most elements of AOCI in regulatory capital. This opt-out, which was required to be made in the first quarter of 2015, excluded from regulatory capital both unrealized gains and losses on available-for-sale debt securities and accumulated net gains and losses on cash-flow hedges and amounts attributable to defined benefit post-retirement plans. The Company elected to opt-out.

Generally, financial institutions (except for large, internationally active financial institutions) became subject to the new rules on January 1, 2015. However, there are separate phase-in/phase-out periods for: (i) the capital conservation buffer; (ii) regulatory capital adjustments and deductions; (iii) non-qualifying capital instruments; and (iv) changes to the prompt corrective action rules. The phase-in periods commenced on January 1, 2016, and extend until 2019.

PROMPT CORRECTIVE ACTION

A banking organization's capital plays an important role in connection with regulatory enforcement as well. Federal law provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions. The extent of the regulators' powers depends on whether the institution in question is "adequately capitalized," "undercapitalized," "significantly undercapitalized," or "critically undercapitalized," in each case as defined by regulation. Depending upon the capital category of an institution that is not adequately capitalized, the regulators' corrective powers include: (i) requiring the institution to submit a capital restoration plan; (ii) limiting the institution's asset growth and restricting its activities; (iii) requiring the institution to issue additional capital stock (including additional voting stock) or to be acquired; (iv) restricting transactions between the institution and its affiliates; (v) restricting the interest rate that the institution may pay on deposits; (vi) ordering a new election of directors of the institution; (vii) requiring that senior executive officers or directors be dismissed; (viii) prohibiting the institution from accepting deposits from correspondent banks; (ix) requiring the institution to divest certain subsidiaries; (x) prohibiting the payment of principal or interest on subordinated debt; and (xi) ultimately, appointing a receiver for the institution.

As of December 31, 2017 and 2016: (i) the Bank exceeded its minimum regulatory capital requirements under OCC capital adequacy guidelines; and (ii) the Bank was "well- capitalized," as defined by OCC regulations. As of December 31, 2017 and 2016, the Company had regulatory capital in excess of the Federal Reserve's requirements and met the Dodd-Frank Act's capital requirements.

THE COMPANY

GENERAL

The Company, as the sole stockholder of the Bank, is a financial holding company. As a financial holding company, the Company is registered with, and is subject to regulation by, the Federal Reserve under the Bank Holding Company Act of 1956, as amended (the "BHCA"). In accordance with Federal Reserve policy, and as now codified by the Dodd-Frank Act, the Company is legally obligated to act as a source of financial strength to the Bank and to commit resources to support the Bank in circumstances where the Company might not otherwise do so. Under the BHCA, the Company is subject to periodic examination by the Federal Reserve. The Company is required to file with the Federal Reserve periodic reports of the Company's operations and such additional information regarding the Company and its subsidiaries as the Federal Reserve may require.

DIVIDEND PAYMENTS

The Company's ability to pay dividends to its stockholders may be affected by both general corporate law considerations and the policies of the Federal Reserve applicable to bank holding companies. As a Delaware corporation, the Company is subject to Delaware general corporation law ("DGCL"). DGCL allows the Company to pay dividends only out of its surplus (as defined and computed in accordance with DGCL) or, if the Company has no such surplus, out of its net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year.

As a general matter, the Federal Reserve has indicated that the board of directors of a financial holding company should eliminate, defer, or significantly reduce dividends to stockholders if: (i) the Company's net income available to stockholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends; (ii) the prospective rate of earnings retention is inconsistent with the Company's capital needs and overall current and prospective financial condition; or (iii) the Company will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios. The Federal Reserve also possesses enforcement powers over bank holding companies and their nonbank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability to proscribe the payment of dividends by banks and bank holding companies.

THE BANK

GENERAL

The Bank is a national bank, chartered by the OCC under the National Bank Act. The deposit accounts of the Bank are insured by the FDIC's Deposit Insurance Fund (the "DIF") to the maximum extent provided under federal law and FDIC regulations, and the Bank is a member of the Federal Reserve System. As a national bank, the Bank is subject to the examination, supervision, reporting, and enforcement requirements of the OCC. The FDIC, as administrator of the DIF, also has regulatory authority over the Bank.

DEPOSIT INSURANCE

As an FDIC-insured institution, the Bank is required to pay deposit insurance premium assessments to the FDIC. The FDIC has adopted a risk-based assessment system whereby FDIC-insured depository institutions pay insurance premiums at rates based on their risk classification. An institution's risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to the regulators.

The Dodd-Frank Act permanently increased the maximum amount of deposit insurance for banks, savings institutions, and credit unions to $250,000 per insured depositor, retroactive to January 1, 2009.

BANK DIVIDEND PAYMENTS

The primary source of funds for the Company is dividends from the Bank. Under the National Bank Act, a national bank may pay dividends out of its undivided profits in such amounts and at such times as the bank's board of directors deems prudent. Without prior OCC approval, however, a national bank may not pay dividends in any calendar year that, in the aggregate, exceed the bank's year-to-date net income plus the bank's retained net income for the two preceding years.

The payment of dividends by any financial institution is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and a financial institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized. As described above, the Bank exceeded its minimum capital requirements under applicable guidelines as of December 31, 2017 and 2016. Notwithstanding the availability of funds for dividends, however, the OCC may prohibit the payment of dividends by the Bank if it determines such payment would constitute an unsafe or unsound practice.

SAFETY AND SOUNDNESS STANDARDS/RISK MANAGEMENT

The federal banking agencies have adopted guidelines that establish operational and managerial standards to promote the safety and soundness of federally insured depository institutions. The guidelines set forth standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality, and earnings.

During the past decade, the bank regulatory agencies have increasingly emphasized the importance of sound risk management processes and strong internal controls when evaluating the activities of the institutions they supervise. Properly managing risks has been identified as critical to the conduct of safe and sound banking activities and has

become even more important as new technologies, product innovation, and the size and speed of financial transactions have changed the nature of banking markets. The agencies have identified a spectrum of risks facing a banking institution including, but not limited to, credit, market, liquidity, operational, legal, and reputational risk.

Information security risks for financial institutions have generally increased in recent years in part because of the proliferation of new technologies, the use of the Internet and telecommunications technologies to conduct financial transactions, and the increased sophistication and activities of organized crime, hackers, terrorists, activists, and other external parties. The Company relies on the secure processing, transmission, and storage of confidential information in our computer systems and networks. Cybersecurity and the continued development and enhancement of the controls, processes, and systems designed to protect our networks, computers, software, and data is a priority for the Company.

COMMUNITY REINVESTMENT ACT REQUIREMENTS

The Community Reinvestment Act requires the Bank to have a continuing and affirmative obligation in a safe and sound manner to help meet the credit needs of its entire community, including low- and moderate- income neighborhoods. Federal regulators regularly assess the Bank's record of meeting the credit needs of its communities. Applications for additional acquisitions would be affected by the evaluation of the Bank's effectiveness in meeting its Community Reinvestment Act requirements.

CONSUMER FINANCIAL SERVICES

There are numerous developments in federal and state laws regarding consumer financial products and services that impact the Bank's business. Importantly, the current structure of federal consumer protection regulation applicable to all providers of consumer financial products and services changed significantly on July 21, 2011, when the CFPB commenced operations to supervise and enforce consumer protection laws. The CFPB has broad rulemaking authority for a wide range of consumer protection laws that apply to all providers of consumer products and services, including the Bank, as well as the authority to prohibit "unfair, deceptive, or abusive" acts and practices. The CFPB has examination and enforcement authority over providers with more than $10 billion in assets. Banks and savings institutions with $10 billion or less in assets, like the Bank, will continue to be examined by their applicable bank regulators. Below are additional recent regulatory developments relating to consumer mortgage lending activities. The Company does not currently expect these provisions to have a significant impact on Bank operations; however, additional compliance resources were added to monitor compliance.

ABILITY-TO-REPAY REQUIREMENT AND QUALIFIED MORTGAGE RULE

The Dodd-Frank Act contains additional provisions that affect consumer mortgage lending. First, it significantly expands underwriting requirements applicable to loans secured by 1-4 family residential real property and augments federal law combating predatory lending practices. In addition to numerous new disclosure requirements, the Dodd-Frank Act imposes new standards for mortgage loan originations on all lenders, including banks and savings associations, in an effort to strongly encourage lenders to verify a borrower's ability to repay, while also establishing a presumption of compliance for certain "qualified mortgages."

On January 10, 2013, the CFPB issued a final rule, effective January 10, 2014, that implements the Dodd-Frank Act's ability- to-repay requirements and clarifies the presumption of compliance for "qualified mortgages." In assessing a borrower's ability to repay a mortgage-related obligation, lenders generally must consider eight underwriting factors: (i) current or reasonably expected income or assets; (ii) current employment status; (iii) monthly payment on the subject transaction; (iv) monthly payment on any simultaneous loan; (v) monthly payment for all mortgage-related obligations; (vi) current debt obligations, alimony, and child support; (vii) monthly debt-to-income ratio or residual income; and (viii) credit history. Further, the final rule also clarifies that qualified mortgages do not include "no-doc" loans and loans with negative amortization, interest-only payments, balloon payments, terms in excess of 30 years, or points and fees paid by the borrower that exceed 3% of the loan amount, subject to certain exceptions. In addition, for qualified mortgages, the monthly payment must be calculated on the highest payment that will occur in the first five years of the loan, and the borrower's total debt-to-income ratio generally may not be more than 43%.

FORWARD-LOOKING STATEMENTS

The following information appears in accordance with the Private Securities Litigation Reform Act of 1995:

This annual report contains forward-looking statements about Alerus Financial Corporation. Statements that are not historical or current facts, including statements about beliefs and expectations, are forward-looking statements and are based on the information available to, and assumptions and estimates made by, management as of the date made. These forward-looking statements cover, among other things, anticipated future revenue and expenses and the future plans and prospects of Alerus Financial Corporation. Forward-looking statements involve inherent risks and uncertainties, and important factors could cause actual results to differ materially from those anticipated. Global and domestic economies could fail to recover from the recent economic downturn or could experience another severe contraction, which could adversely affect Alerus Financial Corporation's revenues and the values of its assets and liabilities. Global financial markets could experience a recurrence of significant turbulence, which could reduce the availability of funding to certain financial institutions and lead to a tightening of credit, a reduction of business activity, and increased market volatility. Alerus Financial Corporation's results could also be adversely affected by continued deterioration in general business and economic conditions; changes in interest rates; deterioration in the credit quality of its loan portfolios or in the value of the collateral securing those loans; deterioration in the value of securities held in its investment securities portfolio; legal and regulatory developments; increased competition from both banks and non-banks; cyber-attacks; changes in client behavior and preferences; effects of mergers and acquisitions and related integration; effects of critical accounting policies and judgments; and management's ability to effectively manage credit risk, residual value risk, market risk, operational risk, interest rate risk, liquidity risk, and cybersecurity.

Forward-looking statements speak only as of the date they are made, and Alerus Financial Corporation undertakes no obligation to update them in light of new information or future events.

Executive Vice President and Chief Financial Officer
Alerus Financial Corporation
March 2, 2018

ALERUS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
At December 31,
(dollars in thousands, except share and per share amounts)

	2017	2016
Assets		
Cash and cash equivalents	$ 40,336	$ 35,441
Interest-bearing deposits	81,662	171,926
Cash and due from banks	121,998	207,367
Investment securities		
Securities held for trading	1,945	1,959
Securities available for sale	272,466	276,952
Loans held for sale	17,938	35,063
Loans	1,574,474	1,366,952
Less allowance for loan losses	(16,564)	(15,615)
Net loans	1,557,910	1,351,337
Premises and equipment, net	21,229	24,262
Accrued interest receivable	6,817	5,919
Bank-owned life insurance	29,959	29,139
Goodwill	27,329	27,329
Other intangible assets, net	31,797	37,506
Deferred income taxes	9,213	19,521
Other assets	38,457	34,225
Total assets	$ 2,137,058	$ 2,050,579
Liabilities and Stockholders' Equity		
Deposits		
Noninterest-bearing	$ 619,333	$ 554,490
Interest-bearing	1,215,629	1,230,719
Total deposits	1,834,962	1,785,209
Short-term borrowings	30,000	729
Long-term debt	58,819	58,813
Accrued expenses and other liabilities	32,706	37,043
Total liabilities	1,956,487	1,881,794
Stockholders' equity		
Common stock, $1 par value, 30,000,000 shares authorized; 13,699,066 and 13,534,375 issued and outstanding	13,699	13,534
Additional paid-in capital	26,040	23,882
Retained earnings	141,963	133,307
Accumulated other comprehensive income	(1,131)	(1,938)
Total stockholders' equity	180,571	168,785
Total liabilities and stockholders' equity	$ 2,137,058	$ 2,050,579

ALERUS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
Year Ended December 31,
(dollars and shares in thousands, except per share data)

	2017	2016	2015
Interest Income			
Loans and leases, including fees	$ 68,799	$ 63,644	$ 51,731
Investment securities			
Taxable	4,773	4,584	3,496
Exempt from federal income taxes	1,356	1,089	808
Other	709	625	293
Total interest income	75,637	69,942	56,328
Interest Expense			
Deposits	3,520	3,385	2,758
Short-term borrowings	942	11	18
Long-term debt	3,505	3,606	682
Total interest expense	7,967	7,002	3,458
Net interest income	67,670	62,940	52,870
Provision for loan losses	3,280	3,060	4,200
Net interest income after provision for credit losses	64,390	59,880	48,670
Noninterest Income			
Retirement and benefit services	62,234	57,804	51,059
Wealth management	14,109	12,640	11,418
Mortgage banking	20,700	28,296	24,630
Service charges on deposit accounts	1,854	1,916	1,611
Net gain (loss) on investment securities	(13)	(24)	(17)
Other	4,575	4,449	4,554
Total noninterest income	103,459	105,081	93,255
Noninterest Expense			
Salaries and incentives	67,576	70,739	59,122
Employee benefits and taxes	16,490	15,975	12,804
Net occupancy	6,266	6,437	5,203
Furniture and equipment	5,568	6,018	5,018
Intangible amortization	5,623	7,005	4,361
Other	33,397	37,618	31,626
Total noninterest expense	134,920	143,792	118,134
Income before income taxes	32,929	21,169	23,791
Income tax expense	17,485	7,138	6,683
Net income	15,444	14,031	17,108
Less preferred stock dividends	-	25	200
Net income applicable to common stock	$ 15,444	$ 14,006	$ 16,908
Earnings per common share	$ 1.13	$ 1.04	$ 1.26
Diluted earnings per common share	$ 1.10	$ 1.00	$ 1.21
Dividends declared per common share	$ 0.48	$ 0.44	$ 0.42
Average common shares outstanding	13,653	13,495	13,413
Diluted average common shares outstanding	14,007	14,000	13,947

ALERUS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(dollars and shares in thousands, except per share data)

	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance December 31, 2014	**$ 20**	**$ 13,346**	**$ 41,092**	**$ 115,258**	**$ 1,370**	**$ 171,086**
Net income	-	-	-	17,108	-	17,108
Other comprehensive income	-	-	-	-	(321)	(321)
Common stock repurchased	-	(1)	(26)	-	-	(27)
Common stock issued	-	16	299	-	-	315
Preferred stock dividends	-	-	-	(200)	-	(200)
Common stock dividends	-	-	-	(5,859)	-	(5,859)
Tax benefit equity related items	-	-	606	(606)	-	-
Stock-based compensation expense	-	-	719	-	-	719
Vesting of restricted stock	-	73	(73)	-	-	-
Balance December 31, 2015	**20**	**13,434**	**42,617**	**125,701**	**1,049**	**182,821**
Net income	-	-	-	14,031	-	14,031
Other comprehensive income	-	-	-	-	(2,987)	(2,987)
Common stock repurchased	-	(18)	(102)	(237)	-	(357)
Common stock issued	-	20	345	-	-	365
Preferred stock dividends	-	-	-	(25)	-	(25)
Common stock dividends	-	-	-	(6,163)	-	(6,163)
Stock-based compensation expense	-	-	1,100	-	-	1,100
Vesting of restricted stock	-	98	(98)	-	-	-
Preferred stock redeemed	(20)	-	(19,980)	-	-	(20,000)
Balance December 31, 2016	**-**	**13,534**	**23,882**	**133,307**	**(1,938)**	**168,785**
Net income	-	-	-	15,444	-	15,444
Other comprehensive income	-	-	-	172	807	979
Common stock repurchased	-	(16)	(47)	(231)	-	(294)
Common stock issued	-	64	1,384	-	-	1,448
Common stock dividends	-	-	-	(6,729)	-	(6,729)
Stock-based compensation expense	-	17	921	-	-	938
Vesting of restricted stock	-	100	(100)	-	-	-
Balance December 31, 2017	**$ -**	**$ 13,699**	**$ 26,040**	**$ 141,963**	**$ (1,131)**	**$ 180,571**

ALERUS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
Year Ended December 31,
(dollars in thousands)

	2017	2016	2015
Operating Activities			
Net income	$ 15,444	$ 14,031	$ 17,108
Adjustments to reconcile net income to net cash			
Deferred income taxes	9,745	(3,044)	581
Provision for loan losses	3,280	3,060	4,200
Provision for foreclosed asset losses	425	226	53
Depreciation and amortization	9,856	11,385	8,727
Stock-based compensation	938	1,465	1,034
Investment securities premium amortization	2,069	2,364	636
Increase in value of bank-owned life insurance	(820)	(831)	(824)
Realized loss (gain) on forward sale derivatives	97	(81)	(186)
Realized loss (gain) on rate lock commitments	(70)	135	139
Realized loss (gain) on sale of premises and equipment	154	6	-
Realized loss (gain) on sale of foreclosed assets	38	73	540
Realized loss (gain) on sale of investment securities	-	17	-
Realized loss (gain) on servicing rights	(743)	(1,293)	(1,178)
Net change in			
Securities held for trading	14	(12)	13
Loans held for sale	17,125	13,579	(13,600)
Accrued interest receivable	(898)	(1,089)	(56)
Other assets	(2,136)	313	(2,867)
Accrued expenses and other liabilities	(6,628)	(6,315)	10,039
Net cash provided by operating activities	47,890	33,989	24,359
Investing Activities			
Proceeds from sales of investment securities available for sale	325	59,910	-
Proceeds from maturities of investment securities available for sale	42,570	42,806	40,096
Purchases of investment securities available for sale	(38,551)	(82,487)	(27,490)
Net increase in loans	(210,286)	(38,884)	(38,723)
Net cash paid for business combinations	-	(45,441)	(4,314)
Proceeds from bank-owned life insurance	-	5,331	-
Purchases of premises and equipment	(2,946)	(1,684)	(3,906)
Proceeds from sales of premises and equipment	2,390	404	-
Proceeds from sales of foreclosed assets	1,405	636	2,126
Net cash used by investing activities	(205,093)	(59,409)	(32,211)
Financing Activities			
Net increase in deposits	49,754	25,020	195,853
Net increase (decrease) in short-term borrowings	29,271	(6,847)	(10,532)
Repayments of long-term debt	(168)	(25,000)	(125)
Proceeds from issuance of subordinated debt	-	-	49,375
Cash dividends paid on preferred stock	-	(25)	(200)
Cash dividends paid on common stock	(6,729)	(6,163)	(5,859)
Redemption of preferred stock	-	(20,000)	-
Repurchase of common stock	(294)	(357)	(27)
Net cash provided (used) by financing activities	71,834	(33,372)	228,485
Net change in cash and due from banks	(85,369)	(58,792)	220,633
Cash and due from banks at beginning of year	207,367	266,159	45,526
Cash and due from banks	$ 121,998	$207,367	$ 266,159

Supplemental Cash Flow Disclosures	2017	2016	2016
Loan collateral transferred to foreclosed assets	$ 433	$ 1,851	$ 684
Unrealized gain/(loss) on securities available for sale	807	(2,987)	(321)
Interest paid for the period	8,026	7,263	3,381
Income tax payments net of refunds received	13,074	1,612	10,165
Noncash assets acquired	-	335,830	4,572
Liabilities assumed	-	(328,748)	(258)
Net noncash asset acquired	-	7,082	4,314
Cash and due from banks acquired	-	18,748	-

CliftonLarsonAllen LLP
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INDEPENDENT AUDITORS' REPORT

Board of Directors and Audit Committee
Alerus Financial Corporation and Subsidiaries
Grand Forks, North Dakota

We have audited, in accordance with the auditing standards generally accepted in the United States of America, the consolidated financial statements of Alerus Financial Corporation and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for years ended December 31, 2017, 2016, and 2015, and the related notes to the consolidated financial statements (not presented herein); and in our report dated February 28, 2018, we expressed an unqualified opinion on those consolidated financial statements.

Opinion

In our opinion, the information set forth in the accompanying consolidated balance sheets, statements of income, changes in stockholders' equity and cash flows is fairly stated, in all material respects, in relation to the consolidated financial statements from which it was derived.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Minneapolis, Minnesota
February 28, 2018

A member of
Nexia
International

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